



## Summary of Covenants Not To Compete: A Global Perspective

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## ALABAMA

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## ALABAMA

### I. STATUTORY CRITERIA FOR NON-COMPETE AGREEMENTS

Section 8-1-1 of the Alabama Code governs the enforceability of contracts in restraint of trade, including covenants not-to-compete and non-solicitation agreements. See ALA. CODE § 8-1-1 (1975); *Sevier Ins. Agency, Inc. v. Willis Corroon Corp.*, 711 So.2d 995, 998 (Ala. 1998) (“[T]he classification of an agreement either as a covenant not-to-compete or as a nonsolicitation agreement is not determinative of the question whether the particular agreement is valid or invalid under the provisions of § 8-1-1.”). Section 8-1-1(a) states that “[e]very contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind otherwise than is provided by this section is to that extent void.”

The statute sets forth two exceptions to this general voidance of all contracts in restraint of trade. Section 8-1-1(b) permits certain contracts in restraint of trade in the context of an employer-employee relationship, or in the context of the sale of a business’s good will. Section 8-1-1(b) provides that “[o]ne who sells the good will of a business may agree with the buyer and one who is employed as an agent, servant or employee may agree with his employer to refrain from carrying on or engaging in a similar business and from soliciting old customers of such employer within a specified county, city, or part thereof so long as the buyer, or any person deriving title to the good will from him, or employer carries on a like business therein.”

Section 8-1-1(c) permits agreements among partners, upon or in anticipation of a dissolution of the partnership, “that none of them will carry on a similar business within the same county, city or town, or within a specified part thereof, where the partnership business has been transacted.”

### II. LEADING CASE LAW

Alabama courts have repeatedly held that § 8-1-1 expresses the public policy of the state disfavoring non-compete agreements. See *Clark Substations, LLC v. Ware*, 838 So.2d 360, 363 (Ala. 2002); *Pitney Bowes, Inc. v. Berney Office Solutions*, 823 So.2d 659, 662 (Ala. 2001). Such agreements are disfavored “because they tend not only to deprive the public of efficient service, but tend to impoverish the individual.” See *Robinson v. Computer Servicenters, Inc.*, 346 So.2d 940, 943 (Ala. 1977). Therefore, a non-compete agreement is void unless it falls within the limited exceptions set forth in § 8-1-1. See *Clark*, 838 So.2d at 363. The person or entity seeking to enforce a non-compete agreement has the burden of showing that the agreement is not void under § 8-1-1. See *id.*

To the extent a contract restrains the practice of a lawful profession, it is void under § 8- 1-1(a) as against public policy. See *Anniston Urologic Associates, P. C. v. Kline*, 689 So.2d 54, 56 (Ala. 1997) (affirming the voidance of a physician’s non-compete agreement); *Pierce v. Hand, Arendall, Bedsole, Greaves & Johnston*, 678 So.2d 765 (Ala. 1996) (affirming the voidance of a lawyer’s non-compete agreement); *Fridde v. Raymond*, 575 So.2d 1038 (Ala. 1991) (affirming the voidance of a veterinarian’s non-compete agreement); *Cherry, Bekaert & Holland v. Brown*, 582 So.2d 502 (Ala. 1991) (affirming voidance of an accountant’s non-compete agreement); *Salisbury v. Semple*, 565 So.2d 234 (Ala. 1990) (affirming the voidance of an ophthalmologist’s non-compete agreement). Non-compete agreements governing professionals do not fall under the statutory exception contained in § 8-1-1(b) because that subsection only pertains to a “business,” to an “agent, servant, or employee,” or to soliciting old “customers” of a former “employer.” *Odess v. Taylor*, 211 So.2d 805, 811 (Ala. 1968). Further, § 8-1-1(c) has been interpreted as applying only to nonprofessional partnerships. See *Hoppe v. Preferred Risk Mut. Ins. Co.*, 470 So.2d 1161, 1163 (Ala. 1985).

### III. ELEMENTS OF ENFORCEABILITY

#### A. Agreements Arising in an Employment Context

In order for a non-compete covenant in an employment contract to be upheld under § 8- 1-1(b), an employer must show that: (1) the employer has a protectable interest; (2) the restriction is reasonably related to that interest; (3) the restriction is reasonable in time and place; and (4) the restriction imposes no undue hardship. *DeVoe v. Cheatham*, 413 So.2d 1141 (Ala. 1982); *Nationwide Mut. Ins. Co. v Cornutt*, 907 F.2d 1085 (11th Cir. 1990). A party must present affirmative evidence showing that the agreement is valid under the circumstances of the case. *Jones v. Wedgworth Pest Control, Inc.*, 763 So.2d 261 (Ala.Civ.App. 2000). Justification for covenants not-to-compete generally must be on the ground that the employer has a legitimate interest in restraining the employee from appropriating valuable trade information and customer relationships to which he has had access in the course of his employment. See *Sheffield v. Stoudenmire*, 553 So.2d 125, 126 (Ala. 1989).

1. Protectable interests: In order to have a protectable interest, the employer must possess “a substantial right in its business sufficiently unique to warrant the type of protection contemplated by [a] noncompetition agreement.” *Cullman Broadcasting Co. v. Bosley*, 373 So.2d 830, 836 (Ala. 1979). Protectable interests include, but are not limited to: valuable customer relationships and goodwill that have been established by the defendant as an employee of the plaintiff and confidential information, such as trade secrets and confidential business practices. *Ormco Corp. v. Johns*,

2003 WL 2007816, \*6 (Ala. 2003). If an employee is in a position to gain confidential information, access to secret lists, or to develop a close relationship with clients, the employer may have a protectable interest in preventing that employee from competing. DeVoe, 413 So.2d at 1143. This is particularly so in fields where the acquisition and protection of customer lists and a regular clientele are of crucial importance. Nationwide, 907 F.2d at 1087 (citing *Daniel v. Trade Winds Travel, Inc.*, 532 So.2d 653, 654 (Ala.Civ.App. 1988)).

A protectable interest can also arise from the employer's investment in its employee in terms of time, resources and responsibility. Nationwide, 907 F.2d at 1088; see also *Ex Parte Caribe, U.S.A., Inc.*, 702 So.2d 1234, 1236 (Ala. 1997) (holding that information was confidential, proprietary and protectable because of the need for expertise, time, money, or a substantial combination of these resources to assemble it).

A simple labor skill, without more, is simply not enough to give an employer a substantial protectable right unique in his business. To hold otherwise would place an undue burden on the ordinary laborer and prevent him or her from supporting his or her family. DeVoe, 413 So.2d at 1143.

2. Geographic Territory Restrictions: The territory of a covenant not-to-compete may properly include part of Alabama, all of Alabama or more territory than the state of Alabama, depending on the circumstances. *James S. Kemper & Co. Southeast, Inc. v. Cox & Associates, Inc.*, 434 So.2d 1380, 1385 (Ala. 1983) (citing *Parker v. EBSCO Industries, Inc.*, 209 So.2d 383 (Ala.1968)). In determining the question as to reasonableness of territorial limitations, "the court will consider the nature and extent of the trade or business, the situation of the parties, and all the other circumstances." *Parker*, 209 So.2d at 388.
3. Time Limitations: Alabama courts have generally held that covenants not-to-compete for two years are reasonable. See *Unisource Worldwide, Inc. v. South Central Alabama Supply, LLC*, 199 F.Supp.2d 1194, 1205 (M.D. Ala. 2001) (citing *Kemper*, 434 So.2d at 1384). At least one Alabama court has upheld a covenant not-to-compete for five years, see *Slay v. Hess*, 41 So.2d 582 (Ala. 1949); however, the reasonableness of such a restriction depends on the facts of each case. See *Mason Corp. v. Kennedy*, 244 So.2d 585, 590 (Ala. 1971).

4. Undue Hardship: When assessing hardship, courts may examine the former employee's age, marital or parental status, financial obligations, or lack of training in other areas. See *Sheffield*, 553 So.2d at 127 (finding undue hardship where a covenant purported to restrain a 50-year-old married former employee, with significant financial obligations, from competing within 50 miles of his former employer for 5 years); *Birmingham Television Corp. v. DeRamus*, 502 So.2d 761, 764 (Ala. Civ. App. 1986) (finding undue hardship where a covenant purported to restrain a 25-year-old former employee, who had recently been married, from employment as a television time salesman in or around Birmingham for a period of 6 months). In analyzing the hardship factor, the courts may consider "the injury which may result to the public from restraining the breach of the covenant in the loss of the employee's service and skill and the danger of his becoming a charge on the public." *Hill v. Rice*, 67 So.2d 789, 794 (1953).
  
5. Scope of Activity Restrained: Employees "cannot be prevented from plying their trades by blanket post-employment restraints." *Chavers v. Copy Products Co., Inc.*, of Mobile, 519 So.2d 942, 945 (Ala. 1988) (voiding covenant not-to-compete where the effect of the covenant blanketly forbid a copier technician from working in any capacity in the copier service industry in a wide geographical area). Moreover, an employer may only enforce post-employment restraints so long as the employer carries on a like business. See *ISS Intern. Service Systems, Inc. v. Alabama Motor Exp., Inc.*, 686 So.2d 1184, 1189 (Ala.Civ.App. 1996) (affirming trial court's finding that employees' activities did not violate a non-solicitation covenant where the former employer had ceased its operations and sold all of its customer contracts).

Section 8-1-1 was intended to address all restraints of trade, both reasonable and unreasonable, and both partial and total. See *Sevier*, 711 So.2d at 999. Therefore, § 8-1-1 voids all contracts, including non-compete and non-solicitation agreements, unless the contract meets one of the exceptions contained in §§ 8-1-1(b) or 8-1-1(c). See *id.*

6. Consideration: Continued employment, including at-will employment, is sufficient consideration for a non-competition agreement. See *Corson v. Universal Door Systems, Inc.*, 596 So.2d 565, 568 (Ala. 1991); *Daughtry v. Capital Gas Co., Inc.*, 229 So.2d 480 (Ala. 1969); *Clark v. Liberty National Life Insurance Co.*, 592 So.2d 564 (Ala. 1992); *Condelles v. Alabama Telecasters, Inc.*,

530 So.2d 201, 204 (Ala. 1988). A covenant need not be signed at the beginning of employment in order to be enforceable, Daughtry, 229 So.2d at 481-483, but an employer/employee relationship must exist at the time the agreement is executed. See *Pitney Bowes*, 823 So.2d at 662.

Section 8-1-1 presupposes non-compete agreements are supported by consideration. See *Pitney Bowes*, 823 So.2d at 662. According to the Alabama Supreme Court, the Legislature would not need to adopt a statute to void non-compete agreements that were not supported by consideration, as they would be unenforceable for lack of consideration even without the statute. *Id.*

7. Judicial Modification: When an agreement in restraint of trade contains unreasonable limitations, the court may strike the unreasonable restriction from the agreement, or the court can enforce the contract within its reasonable limits. See *Kershaw v. Knox Kershaw, Inc.*, 523 So.2d 351, 359 (Ala. 1988); *Cullman*, 373 So.2d at 835 (“An agreement in restraint of trade may be divisible. An unreasonable limitation or restriction may be stricken....”). See *Corson*, 596 So.2d at 569 (affirming the courts ability to reform a non-solicitation covenant with geographic scope of several states to non-solicitation of any customers of the employer); *Nationwide*, 907 F.2d at 1088 (citation omitted) (modifying restriction on soliciting former employer’s policyholders to soliciting those who were agent’s personal customers). But see *Chavers*, 519 So.2d at 942 (holding a restriction within a radius of 75 miles for two years void since it would pose undue hardship on the former employee).

Where a court chooses to enforce a contract within its reasonable limits, it may do so by granting an injunction restraining the respondent from competing for a reasonable time and within a reasonable area. See *Mason*, 244 So.2d at 590 (“We hold that a court of equity has the power to enforce a contract against competition although the territory or period stipulated may be unreasonable, by granting an injunction restraining the respondent from competing for a reasonable time and within a reasonable area.”).

The terms of non-compete agreements will be construed in connection with attendant circumstances, and, though there is no expression in its terms of the territory embraced, the extent of such territory may be inferred from such circumstances. See *Parker*, 209 So.2d at 387 (citing *Moore & Handley v. Towers*, 6 So. 41 (Ala. 1889)). The same has also been held with respect to the time of its

operation when not expressed. See *Parker*, 209 So.2d at 387 (citing *Smith v. Webb*, 58 So. 913 (Ala. 1912)).

## **B. Agreements Ancillary to the Sale of Business**

In order for a non-compete agreement ancillary to the sale of a business to be upheld under § 8-1-1(b), the seller must show: (1) a “sale,” (2) a sale of good will, (3) that the covenant is restricted as to territory; and (4) that the buyer is carrying on a like business. *Kershaw*, 523 So.2d at 357.

1. **Sale:** The transfer or exchange of stock in a merger constitutes a “sale.” *Kershaw*, 523 So.2d at 357. The party bound by the non-compete agreement must constitute a “seller” for purposes of the application of § 8-1-1(b). See *Livingston v. Dobbs*, 559 So.2d 569 (Ala. 1990) (holding that a wife who, as part of divorce settlement, received the balance due on the purchase price for a business was not a “seller”).
2. **Sale of Good Will:** A sale may constitute a “sale of good will” even where good will was not specified as an asset in the sale so long as good will was “incident to and inherent in” the business itself. *Kershaw*, 523 So.2d at 358. Covenants not-to-compete that are designed to protect the goodwill of a business being sold imply a sale of goodwill. See *Gilmore Ford, Inc. v. Turner*, 599 So.2d 29, 31 (Ala. 1992). No implied covenant not-to-compete arises from a sale of a professional business and its good will. See *Joseph v. Hopkins*, 158 So.2d 660, 665 (Ala. 1963).
3. **Territorial Restriction:** Covenants not-to-compete ancillary to the sale of a business must be limited as to the territory they are intended to cover, or they cannot be supported. But in determining the territorial restriction, a court is not limited to the express terms of the contract. Courts may look to “all the circumstances surrounding the parties, and attendant upon the transaction, and from a consideration of these circumstances, in connection with the expressions of the undertaking, they will first construe the contract, and then proceed to pass upon its reasonableness as thus construed.” *Moore & Handley*, 6 So. at 42-43. The territorial restriction contained in the non-compete agreement must not be ambiguous or overly broad. See *Kershaw*, 523 So.2d at 359 (holding that a covenant prohibiting a seller of a business from competition in any county or province of the U.S. or Canada where the buyer shall in the future do business in the next 5 years was overly broad and enforcing the non-compete agreement only to the

extent that it prohibited competition in the areas where the buyer had done business prior to the date of the covenant).

#### **IV. SUMMARIZATION OF ALABAMA LAW WITH REGARD TO THE USE OF CONFIDENTIAL INFORMATION**

As with confidential information sought to be protected by a non-compete or nondisclosure covenant, confidential information must be “the subject of efforts that are reasonable under the circumstances to maintain its secrecy” in order to obtain the protections of the Alabama Trade Secret Act. See ALA. CODE § 8-27-2(1)(e). The burden is on the party asserting trade secret protection to show that reasonable steps were taken to protect secrecy. See *Allied Supply Co. v. Brown*, 585 So.2d 33, 36 (Ala. 1991). Certain types of customer lists may constitute trade secrets, including those that contain specific information about customers, e.g. their buying habits, so long as the information was treated by the claimant as secret. See *Public Sys. v. Towry*, 587 So.2d 969, 973 (Ala. 1991). The lists must be more than a list of readily ascertainable potential clients. See, e.g., *Birmingham Television*, 502 So.2d 761.

The Alabama Trade Secret Act defines a “trade secret” as “information that: (a) is used or intended for use in a trade or business; (b) is included or embodied in a formula, pattern, compilation, computer software, drawing, device, method, technique, or process; (c) is not publicly known and is not generally known in the trade or business of the person asserting that it is a trade secret; (d) cannot be readily ascertained or derived from publicly available information; (e) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy; and (f) has significant economic value.” ALA. CODE § 8-27-2.

## ALASKA

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## ALASKA

### I. JUDICIAL STATEMENT OF THE LAW:

There is no state statute that governs the enforceability of covenants not to compete. However, case law indicates that where such a covenant is drafted in good faith and is reasonable, it will be upheld.

### II. PARAMETERS OF THE ENFORCEABILITY TEST:

Factors used to determine enforceability include: (1) absence or presence of limitations as to time and space; (2) whether the employee represents the sole contact with the customer; (3) whether the employee is possessed with confidential information or trade secrets; (4) whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition; (5) whether the covenant seeks to stifle the inherent skill and experience of the employee; (6) whether the benefit to the employer is disproportional to the detriment to the employee; (7) whether the covenant operates as a bar to the employee's sole means of support; (8) whether the employee's talent which the employer seeks to suppress was actually developed during the period of employment; and (9) whether the forbidden employment is merely incidental to the main employment. *Data Mgmt. v. Greene*, 757 P.2d 62, 65 (Alaska 1988).

### III. GENERAL COMMENTS:

- A. Protectable Interests:** Employers have protectable interests in customer lists. *Metcalf Inv., Inc. v. Garrison*, 919 P.2d 1356, 1361 (Alaska 1996). However, if a covenant not to contact former customers would lead to a bar on practicing an individual's specialty, then the covenant is unreasonable. *Id.* Employers also have an interest in confidential information. *Id.* However, if the employee did not have access to confidential information, then a covenant not to contact former employees will also be unreasonable. *Id.*
- B. Scope and Breath:** One case has found that a covenant with no geographic or durational limit was held to be enforceable. *Id.* A 2- year covenant not to perform services for past or present clients has also been upheld. *Wirum & Cash, Architects v. Cash*, 837 P.2d 692, 710-11 (Alaska 1992). However, a 5 year state-wide covenant was deemed unenforceable. *Data Mgmt. v. Greene*, 757 P.2d 62, 3 IER Cases 796 (Alaska 1988). When no durational limits exist, Alaska courts will allow customer restrictions to substitute for geographic terms for certain type of activity covenants. *Metcalf Inv., Inc.*, 919 P.2d at 1361.

- C. Modification:** If a covenant not to compete is overbroad, the court will reasonably alter its language to render the covenant enforceable as long as the covenant was drafted in good faith. *Data Management*, 757 P.2d at 796. Alaska courts have specifically rejected the “blue pencil” approach in favor of a “reasonable alteration” approach. *Id.* at 797. But practically, the reasonable alteration approach seems to have the same or a very similar effect as the blue pencil approach.
- D. Consideration:** The signing of a covenant not to compete at the inception of the employment relationship appears to provide sufficient consideration to support a covenant not to compete, however, the issue has not been directly addressed. *Id.* at 796.
- E. Will a choice of law provision in a contract be followed?** While Alaska has not directly addressed this issue in a covenant not to compete case, Alaska has adopted the “most significant relationship” test in tort cases as well as contract cases. See *M.O. Ehredt v. De-Havilland Aircraft Co. of Canada, Ltd.*, 705 P.2d 446, 453 (Alaska 1985); *Palmer G. Lewis Co. v. Arco Chemical Co.*, 904 P.2d 1221, 1227 & n.14 (Alaska 1995).
- F. Trade Secrets Defined:** A trade secret is defined as: information that (a) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. A.S. 45.50.940 (3).

## ARIZONA

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## ARIZONA

### I. STATEMENT OF THE LAW:

Reasonable covenants not to compete will be enforced if they are “no broader than necessary to protect the employer’s interest.” *Valley Med. Specialists v. Farber*, 982 P.2d 1277, 1283 (Ariz. 1999).

[I]n Arizona . . . a restrictive covenant in an employment agreement, that the employee will not compete within a reasonably limited time and space, is valid and enforceable by injunction where the restraint does not exceed that reasonably necessary for protection of the employer’s business, is not unreasonably restrictive upon right of the employee and does not contravene public policy. . . . [T]he covenant must fall within the requirements of a valid contract, and it must be incident or ancillary to an otherwise legally enforceable contract.

*American Credit Bureau v. Carter*, 462 P.2d 838, 840 (Ariz. Ct. App. 1969) (citing *Lassen v. Benton*, 345 P.2d 37, modified, 347 P.2d 1012 (Ariz. 1959)).

### II. PARAMETERS OF THE “REASONABLENESS” TEST:

#### A. Ancillary to an employment contract:

“Reasonableness is a fact-intensive inquiry that depends on the totality of the circumstances.” *Valley Med. Specialists*, 982 P.2d at 1283. Where the restraint exceeds the employer’s legitimate interest, or where hardship on the employee or likely injury to the public outweigh the interest, the restraint will be found unreasonable and will not be enforced. *Id.* “Covenants not to compete are disfavored and thus are strictly construed against employers.” *Hilb, Rogal and Hamilton Co. of Ariz., Inc. v. McKinney*, 946 P.2d 464, 467 (Ariz. Ct. App. 1997) (citing *Bryceland v. Northey*, 772 P.2d 36, 39 (Ariz. Ct. App. 1989) and *Amex Distrib. Co., Inc. v. Mascari*, 724 P.2d 596, 600 (Ariz. Ct. App. 1986)).

Examples:

1. *Amex Distrib. Co.*, 724 P.2d 596, 605 (36-month restriction on use of customer information unreasonable and unenforceable). “When the restraint is for the purpose of protecting customer relationships, its duration is reasonable only if it is no longer than necessary for the employer to put a new man on the job and for the new

employee to have a reasonable opportunity to demonstrate his effectiveness.” *Id.* at 604 (internal citation and quotation omitted).

2. *Bed Mart, Inc. v. Kelley*, 45 P.3d 1219 (Ariz. Ct. App. 2002) (upholding 6-month restriction within Phoenix Metropolitan area on solicitation of any customer for which the sale of competing product accounted for more than 50% of its revenue).
3. *Bryceland*, 772 P.2d at 39 (refusing to enforce two-year restriction on providing disk jockey services to any client within 50 miles of Phoenix or any of the employee’s job locations).
4. *Lessner Dental Labs. V. Kidney*, 492 P.2d 39, 40-42 (Ariz. Ct. App. 1971) (refusing to enforce two-year restriction on dental technician prohibiting her from engaging in services related to or sales of dental prosthetics and related devices within Pima County).
5. *Olliver/Pilcher Ins., Inc. v. Daniels*, 715 P.2d 1218, 1220 (Ariz. 1986) (refusing to enforce two-year, statewide covenant requiring insurance salesman to pay portion of commissions earned from business with former employer’s customers to former employer as overbroad and unreasonably impacting employee’s right to work in chosen profession).
6. *Liss v. Exel Transp. Servs.*, No. CIV-04-2001-PHX-SMM, 2007 U.S. Dist. LEXIS 20555 at \*23-24 (D. Ariz. Mar. 21, 2007) (covenant restricting employee from “directly or indirectly engaging in any work associated with motor freight transportation services for three years, regardless of where the business is located” was unreasonably broad and placed unreasonable hardship upon plaintiff, “essentially banishing” employee from the industry for three years).

**B. Ancillary to the sale of a business:**

“Courts are more lenient in enforcing [restrictive] covenants given in relation to the sales of businesses because of the need to ensure that goodwill is effectively transferred.” *Valley Med. Specialists v. Farber*, 950 P.2d 1184 (Ct. App. 1997), rev’d on other grounds, 982 P.2d 1277 (Ariz. 1999). “Where limited as to time and space, the covenant is ordinarily valid unless it is to refrain from all business whatsoever.” *Gann v. Morris*, 59 P.2d 43, 44 (Ariz. Ct. App. 1979).

*Gann*, 59 P.2d at 44-45 (upholding 10-year covenant not to engage in silk

screening or lettering shop business within 100 miles of Tucson in connect with sale of business).

### III. GENERAL COMMENTS:

**A. Protectable interests:** “A covenant not to compete is invalid unless it protects some legitimate interest beyond the employer’s desire to protect itself from competition.” *Valley Med. Specialists*, 982 P.2d at 1281 (1999). Legitimate interests include:

1. “[T]o prevent competitive use, for a time, of information or relationships which pertain peculiarly to the employer and which the employee acquired in the course of that employment.” *Valley Med. Specialists*, 982 P.2d at 1281 (internal quotation and citation omitted).
2. “[M]aintaining customer relationships when an employee leaves.” *Bryceland*, 772 P.2d at 40; see also *Bed Mart v. Kelley*, 202 Ariz. 370, 372, 45 P.3d 1219, 1221 (Ct. App. 2002) (“An employer may also have a legitimate interest in having a ‘reasonable amount of time to overcome the former employee’s loss, usually by hiring a replacement and giving that replacement time to establish a working relationship.’”)
3. Retaining customer base, protecting confidential vendor and customer lists; and preserving goodwill with agents, vendors, and customers. *Liss*, 2007 U.S. Dist. LEXIS 20555 at \*23.
4. Referral sources. *Valley Med. Specialists*, 982 P.2d at 1284.

**B. Limits on protectable interests:**

1. A covenant not to compete aimed simply at eliminating competition *per se* will not be enforced. *Amex Distrib. Co.*, 724 P.2d at 604.
2. A former employer cannot seek to restrict a former employee from using skills acquired “on the job,” and, depending on the circumstances, may not restrict former employees from accepting employment with potential (as opposed to actual) customers. *Bryceland*, 772 F.2d at 40. See also *Amex Distrib. Co.*, 724 P.2d at 603-04 (expressing doubt as to reasonableness of covenant applied to “customers other than those with which [the employee] did business, or concerning which he acquired significant customer information”). See also *Lessner*, 492 P.2d at 42.

3. *Hilb, Rogal and Hamilton*, 946 P.2d at 467 (no protectable interest in restricting contact with customer that terminated its business prior to former employee's solicitation of customer).
- C. Anti-piracy or “hands-off” nonsolicitation agreements distinguished:** An anti-piracy agreement is a covenant that “restricts the terminated employee from soliciting customers of his former employer or making use of confidential information from his previous employment.” *Olliver/Pilcher*, 715 P.2d at 1219. Such agreements are less restrictive on employees and the market generally; thus, they are ordinary not found unreasonable or oppressive. *Id.* at 1219-20; see also *Hilb, Rogal and Hamilton*, 946 P.2d at 467; *Alpha Tax Servs., Inc. v. Stuart*, 761 P.2d 1073, 1075 (App. 1988). Thus, even a statewide restrictive covenant was upheld where it was “designed to prevent former employees from using information learned during their employment to divert or to steal customers from the former employer.” *Alpha Tax Servs.*, 761 P.2d at 1075. Cf. *Olliver/Pilcher*, 715 P.2d at 1219 (anti-piracy covenant which required penalty payment for every customer who transferred to new employer, regardless of actionable conduct by former employee, unreasonable).
- D. Blue pencil/modification:** “Arizona courts will ‘blue-pencil’ restrictive covenants eliminating grammatically severable, unreasonable provisions,” but will not add or rewrite terms. *Valley Med. Specialists*, 982 P.2d at 1286. “Where the severability of the agreement is not evident from the contract, the court cannot create a new agreement for the parties to uphold the contract.” *Olliver/Pilcher*, 715 P.2d at 1221. Judicial reformation clauses are unenforceable under Arizona law and, thus, do not permit courts to reform overbroad agreements. *Varsity Gold, Inc. v. Porzio*, 45 P.3d 352, 355 (Ariz. Ct. App. 2002).
- E. Step-down provisions:** Parties may consider using a “step-down” provision, which provides express and grammatically severable alternative geographic restrictions or time restrictions for use in the event the court considers blue penciling the agreement. See, e.g., *Compass Bank v. Hartley*, 430 F. Supp. 2d 973, 980-81 (D. Ariz. 2006) (recognizing issue of first impression; applying Arizona law and using step-down provision to blue pencil and uphold covenant not to compete).
- F. Consideration:** A covenant signed at the inception of an at-will employment relationship is supported by consideration in the form of a promise of continued employment. *Lessner*, 492 P.2d at 40 (finding sufficient consideration where covenant executed at inception of written at-will employment agreement); *Compass*, 430 F. Supp. 2d at 978. It remains unclear whether consideration exists even absent the written at-

will employment agreement. Actual continued at-will employment is sufficient consideration. See *American Credit Bureau v. Carter*, 462 P.2d 838, 840 (Ariz. Ct. App. 1969) (three years of continued at-will employment plus substantial salary); *Mattison v. Johnston*, 730 P.2d 286, 290 (1986) (implied promise of continued employment, albeit at each party's will, followed by employee's voluntary separation three months later). A promise of continued employment, even if it continues on an at-will basis, will support a covenant not to compete executed after the inception of the employment relationship. *Compass*, 430 F. Supp. 2d at 978 (under Arizona law, employer "has the right to require at-will employees to sign . . . restrictive covenants as a condition of continued employment").

**G. Enforceability of "clawbacks" and other forfeitures of benefits:** The validity of a noncompete clause that requires tender back of shares of stock in a company is determined on the same reasonableness test as noncompete covenants in employment contracts. *Fearnow v. Ridenour, Swenson, Cleere & Evans, P.C.*, 138 P.3d 723, 725-26 (2006) (recognizing provision would be governed by "same fact-based reasonableness analysis" if plaintiff were not an attorney).

**H. Is a noncompete covenant enforceable if the employee is discharged?**

Unclear, however it appears discharge will not affect enforceability of the covenant unless express terms indicate otherwise. See, e.g., *American Credit Bureau v. Carter*, 462 P.2d 838, 841 (1969) ("The agreement prohibits competition whether the employee leaves or is fired, implying the cause of termination does not affect the agreement.").

**I. Will an employer's breach of employment agreement relieve the employee of his obligation not to compete?**

Unclear. At least one court has intimated that if an employer is guilty of wrongful conduct in the formation of the contract, a trial court may properly exercise its discretion and not enforce an otherwise valid covenant under the unclean hands doctrine. *American Credit Bureau v. Carter*, 462 P.2d at 841 (employer had unclean hands for inducing former employee to leave prior employment but not notifying employee of noncompete requirement until first day of work).

**J. Will a choice of law provision in a contract be followed?**

Likely. The issue has not yet been addressed in a restrictive covenant case, but Arizona courts typically look to the Restatement (Second) of

Conflict of Laws to determine which jurisdiction's law applies. The Restatement generally applies the law of the chosen state unless it has no relationship with the parties and the transaction or application of the chosen state's law would be contrary to the forum state's fundamental public policy. *In re Estate of Levine*, 700 F.2d 883, 887 (Ariz. Ct. App. 1985).

**K. Trade secrets defined:** Ariz. Rev. Stat. § 44-401.

**L. Limits on restrictive covenants in particular professions:**

Ariz. Rev. Stat. § 23-494: Prohibits broadcasting employers, including television and radio stations and networks, from requiring current or prospective employees to agree to noncompete covenants restricting them from working in a specific geographic area for a specified period of time after employment with broadcasting employer.

Ariz. Sup. Ct. R. 42, Ethical Rule 5.6: Prohibits lawyers from agreeing to restrict the right of a lawyer to practice after termination of employment relationship or dissolution of partnership. However, this rule does not prohibit agreements to impose financial penalties, such as tender back of shares to prior firm, in the event of competition. *Fearnow*, 138 P.3d 723.

"[E]mployment covenants restricting physicians in the practice of medicine involve public policy implications and should therefore be closely scrutinized. *Phoenix Orthopedic Surgeons v. Peairs*, 790 P.2d 752, 758 (Ariz. Ct. App. 1989), overruled on other grounds by *Valley Med. Specialists*, 982 P.2d at 1286 (disapproving portion of *Phoenix Orthopedic* permitting courts to rewrite restrictive covenant). Such agreements are strictly construed for reasonableness due to the special doctor-patient relationship. *Valley Med. Specialists*, 982 F.2d at 1283. Further, the organization's or employer's interest is balanced against "the personal relationship between doctor and patient as well as the patient's freedom to see a particular doctor." *Id.* at 1284.

## ARKANSAS

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## ARKANSAS

### I. OVERVIEW OF THE LAW

#### A. Statutory Statement of the Law

Not applicable.

#### B. Judicial Statement of the Law

1. Under Arkansas law, for a covenant not to compete to be enforceable, three requirements must be met: (a) the covenantee must have a valid interest to protect; (b) the geographical restriction must not be overly broad; and (c) a reasonable time limit must be imposed. *Moore v. Midwest Distribution, Inc.*, 65 S.W.3d 490, 493 (Ark. 2002); *Duffner v. Alberty*, 718 S.W.2d 111, 112 (Ark. App. 1986). See also *Owens v. Penn Mut. Life Ins. Co.*, 851 F.2d 1053, 1054-55 (8th Cir. 1988).
2. Protectable interests include both a stock of customers and trade secrets. See *Statco Wireless, LLC v. Southwestern Bell Wireless, LLC*, 95 S.W.3d 13, 17 (Ark. App. 2003) (vital interest exists “in protecting the confidential information contained in its customer lists, agent compensation plans, written bid proposals, and marketing strategies”); *Moore*, 65 S.W.3d at 493 (“Where a covenant not to compete grows out of an employment relationship, the courts have found an interest sufficient to warrant enforcement of the covenant only in those cases where the covenantee provided special training, or made available trade secrets, confidential business information or customer lists, and then only if it is found that the covenantee was able to use information so obtained to gain an unfair competitive advantage” citing *Federated Mut. Ins. Co. v. Bennett*, 818 S.W.2d 596 (Ark. App. 1991)); *Owens*, 851 F.2d at 1055; *Girard v. Rebsamen Ins. Co.*, 685 S.W.2d 526, 527-28 (citing *Borden, Inc. v. Huey*, 547 S.W.2d 760, 761 (Ark. 1977)); *Olin Water Services v. Midland Research Lab., Inc.*, 596 F. Supp. 412 (E.D. Ark. 1984), *appeal dismissed and remanded*, 774 F.2d 303 (8th Cir. 1985). *Accord Duffner*, 718 S.W.2d at 112-13 (covenant not enforceable where court concluded that doctors remaining with practice did not maintain personal relationship or acquaintance with patients of doctor leaving practice and doctor leaving practice did not appropriate “stock of patients” in leaving).

### II. CONSIDERATION ISSUES

**A. Consideration Generally**

Continued employment is sufficient consideration for a non-compete agreement. *Olin*, 596 F. Supp. at 415; *Credit Bureau Management Co. v. Huie*, 254 F. Supp. 547, 554 (E.D. Ark. 1966).

**III. PARAMETERS OF THE GOVERNING STATUTE AND THE “REASONABLENESS TEST” AS APPLICABLE**

**A. Non-competes Ancillary to an Employment Agreement**

**1. Held Enforceable**

- *Advanced Environmental Recycling Technologies, Inc. v. Advanced Control Solutions, Inc.*, \_\_S.W.3d\_\_; 2008 WL 324358 (Ark. 2008) (upholding jury finding and holding that there was substantial evidenced to support jury’s determination that the state-wide geographic restriction in two-year covenant not to compete was reasonable);
- *Colonial Life & Acc. Ins. Co. v. Sisco*, 1999 WL 258573 (Ark. App. 1999) (insurance salespersons’ covenants not to solicit business for two years from customers whose accounts they serviced during their employment, upheld);
- *Girard v. Rebsamen Ins. Co.*, 685 S.W.2d 526 (Ark. App. 1985) (insurance salesman’s covenant not to solicit or accept business for two years from customers whose accounts he serviced at time of termination, upheld);
- *Borden. Inc. v. Huey*, 547 S.W.2d 760 (Ark. 1977) (covenant not to compete for one year in area where the former employee had sold former employer’s productions, which area encompassed four county seats, upheld);
- *All-State Supply, Inc. v. Fisher*, 483 S.W.2d 210 (Ark. 1972) (former employee/salesman’s covenant not to compete in the entire state of Arkansas for a two-year period upheld as reasonable);
- *Owens*, 851 F.2d at 1055 (covenant restricting competition by former insurance salesman/office manager for two years within 200 miles of former office upheld as reasonable); and

- *Olin*, 596 F. Supp. at 412 (E.D. Ark. 1984) (covenant not to compete for one year in area where former employee most recently sold employer's products, upheld).

## 2. Held Unenforceable or Modified

- *Moore*, 65 S.W.3d 490 (covenant prohibiting competition in a state in which the employer did not conduct business was unreasonably broad as to geographic area);
- *Jaraki v. Cardiology Associates of Northeast Arkansas, P.A.*, 55 S.W.3d 799 (Ark. App. 2001) (covenant not to compete with geographic restriction greater than the former employer's trade area was unreasonably broad and therefore void);
- *City Slickers, Inc. v. Douglas*, 40 S.W.3d 805 (Ark. App. 2001) (5-year confidentiality and nondisclosure covenants executed by the general manager of an on-site automotive oil-changing service found unreasonable);
- *Rector-Phillips-Morse Inc. v. Vroman*, 489 S.W.2d 1 (Ark. 1973) (three-year restraint unreasonable where it exceeded the useful life of the protectable information);
- *Borden Inc. v. Smith*, 478 S.W.2d 744 (Ark. 1972) (Former salesman's agreement not to compete in 59 counties in Arkansas and two counties in each of three other states found unreasonable and unenforceable);
- *Little Rock Towel & Linen Supply Co. v. Independent Linen Service Co. of Arkansas*, 377 S.W.2d 34 (Ark. 1964) (finding time restraint of five years unreasonable and unenforceable; *Am. Excelsior Laundry Co. v. Derisseaux*, 165 S.W.2d 598 (Ark. 1942) (same); and
- *McCumber v. Federated Mut. Implement & Hardware Ins. Co.*, 320 S.W.2d 637 (Ark. 1959) (two-year restraint unreasonable where no trade secrets were involved).

## B. Non-competes Incidental to the Sale of a Business

- *Dawson v. Temps Plus, Inc.*, 987 S.W.2d 722 (Ark. 1999) (covenant not to compete, incidental to sale of 49% interest in temporary employment agency, for five years and within 70 miles of city in which temporary agency was located, upheld);

- *Hyde v. C M Vending Co., Inc.*, 703 S.W.2d 862 (Ark. 1986) (covenant not to compete in food and drink vending business within fifty miles of one city for a period of five years after payment in full of purchase price upheld; purchase price payments to last between eight to ten years, making total restraint thirteen to fifteen years);
- *Madison Bank & Trust v. First Nat'l Bank of Huntsville*, 635 S.W.2d 268 (Ark.1982) (covenant incidental to sale of bank prohibiting new owners of bank from relocating main office or establishing branch within ten-mile radius of Huntsville, Arkansas for ten years upheld);
- *McClure v. Young*, 98 S.W.2d 877 (Ark. 1936) (covenant, incidental to sale of hardware business, not to compete for three years in the same city as the business sold upheld); and
- *Stubblefield v. Siloam Springs Newspapers, Inc.*, 590 F. Supp. 1032 (W.D. Ark. 1984) (covenant, incidental to sale of printing and advertising business, not to compete directly or indirectly for ten years in same county found unreasonably long and therefore void).

#### IV. GENERAL COMMENTS

##### A. Specific Issues

1. Arkansas courts will not equitably modify an unreasonably broad covenant. A covenant that is unreasonable as to the time or geographic restraint, or as to the activities prohibited, is unenforceable and void. *Bendinger v. Marshalltown Trowell Co.*, 994 S.W.2d 468, 473 (Ark. 1999); *Borden, Inc. v. Smith*, 478 S.W.2d at 747; *Brown v. Devine*, 402 S.W.2d 669, 672 (Ark. 1966); *McLeod v. Meyer*, 372 S.W.2d 220, 223 (Ark. 1963).
2. A forfeiture of benefits clause will be evaluated under the same standards as a non-compete covenant. *E.g.*, *Owens*, 851 F.2d at 1054 (clause by which insurance salesman lost 50% of post-termination commissions if he became a manager of a competing agency held to be covenant not to compete).
3. The prevailing party is entitled to a reasonable attorney fee in breach of covenant not to compete cases. *Dawson v. Temps Plus, Inc.*, 987 S.W.2d at 729 (citing Ark. Code Ann. § 16-22-308).
4. Arkansas courts recognize that if an employer commits the first substantial breach of a covenant not to compete, it cannot maintain an action against its former employee for failure to perform. See

*Sisco*, 1999 WL 258573 at \*3 (recognizing “first breach rule” but holding that employer did not breach the covenant not to compete).

5. Choice of law: Arkansas courts employ a multifactored “significant contacts” or “center of gravity” approach in determining the law applicable to contracts. *Olin*, 596 F. Supp. at 414.

## **B. Miscellaneous**

1. A trade secret, defined by the Arkansas Trade Secrets Act, ARK. CODE ANN. §§ 4-75-601 to 607, means information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (a) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. ARK. CODE ANN. § 4-75-601(4).
2. Noteworthy articles and/or publications: Conrad, Christina Rose, *Bendinger v. Marshalltown Trowell Co.*: The Need for Compromising Competition in Arkansas: A Look at the Limits of Covenants Not to Compete, 53 ARK. L. REV. 903 (2000); Pagan, Arkansas Courts and Covenants Not to Compete, 12 U. ARK. LITTLE ROCK L.J., 57, 62-63 (1989).

## CALIFORNIA

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## CALIFORNIA

### **I. STATUTORY STATEMENT OF THE LAW:**

Under California law, covenants not to compete are generally void and unenforceable: “Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.” Cal. Bus. & Prof. Code § 16000.

Express exceptions to this general rule exist for the following business transactions:

- A.** Sale of the goodwill of a business, sale or other disposal of all of an ownership interest in a business entity, or sale of “(a) all or substantially all of its operating assets together with the goodwill of the business entity, (b) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary, or (c) all of the ownership interest of any subsidiary,” where business entities include partnerships, limited liability corporations, and corporations (Cal. Bus. & Profs. Code § 16601);
- B.** Upon or in anticipation of disassociation of a partner from or dissolution of a partnership (Cal. Bus. & Profs. Code § 16602); and
- C.** Upon or in anticipation of a dissolution of or the termination of an ownership interest in a limited liability company (Cal. Bus. & Profs. Code § 16602.5).

To be enforceable, these restrictive covenants must specify the geographic area of the noncompete restriction, which must be limited to the area in which the business entity, partnership, or limited liability company transacted business. Further, the covenant is only valid for as long as the person acquiring the goodwill or ownership interest (§ 16601), a member of the partnership (§ 16602), or a member of the limited liability company (§ 16602.5) carries on a like business within the restricted territory.

### **II. JUDICIAL INTERPRETATION AND APPLICATION OF STATUTES**

“Noncompetition agreements are invalid under section 16600 in California even if narrowly drawn, unless they fall within the applicable statutory exceptions of section 16601, 16602, or 16602.5.” *Edwards v. Arthur Anderson LLP*, 189 P.3d 285, 297 (Cal. 2008).

In the years since its original enactment as Civil Code section 1673, our courts have consistently affirmed that section 16600 evinces a settled public policy in favor of open competition and employee mobility. (See

D'Sa v. Playhut, Inc. (2000) 85 Cal.App.4th 927, 933 [102 Cal. Rptr. 2d 495].) The law protects Californians and ensures “that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.” (*Metro Traffic Control, Inc. v. Shadow Traffic Network* (1994) 22 Cal.App.4th 853, 859 [27 Cal. Rptr. 2d 573].) It protects “the important legal right of persons to engage in businesses and occupations of their choosing.” (*Morlife, Inc. v. Perry* (1997) 56 Cal.App.4th 1514, 1520 [66 Cal. Rptr. 2d 731].)

*Edwards*, 189 P.3d at 291.

#### **A. Ancillary to an employment contract**

California law does not provide an exception to the general rule against restraints of trade for covenants ancillary to an employment contract. While one line of federal cases stemming from a Ninth Circuit Court of Appeal decision recognized a “narrow-restraint” exception, the California Supreme Court subsequently rejected that purported exception and a further argument that the statute may be interpreted to allow reasonable restraints. *Edwards*, 189 P.3d at 291-293 (narrow restraint exception announced in *Campbell v. Trustees of Leland Jr. Univ.*, 817 F.2d 499 (9th Cir. 1987) and followed in *International Business Machines Corp. v. Bajorek*, 191 F.3d 1033 (9th Cir. 1999) and *General Commercial Packaging v. TPS Package*, 126 F.3d 1331 (9th Cir. 1997)).

[W]e are of the view that California courts “have been clear in their expression that section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat.” [citation omitted.] Section 16600 is unambiguous, and if the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect.

*Edwards*, 189 P.3d at 293.

A question remains as to the existence of a trade secret exception to section 16600. California appellate courts have recognized an employer’s ability to prohibit former employees from using its trade secret information. See, e.g., *Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425, 1429 (2003) (all restrictive covenants must pass muster under section 16600 and recognizing an exception as necessary to protect trade secrets). In *Edwards*, the California Supreme Court expressly left open “the applicability of the so-called trade secret exception to section 16600 . . . .” *Edwards*, 189 P.3d 291, n.4. A further question remains as to the enforceability of covenants not to solicit employees and contractors of a former employer and whether they must also be limited to the use of confidential and proprietary information.

## **B. Ancillary to the sale of goodwill in a business**

Section 16601 reflects that when the goodwill of a business is sold, it would be unfair for the seller to engage in competition that diminishes the value of the asset sold. *Hill Med. Corp. v. Wycoff*, 86 Cal. App. 4th 895, 903 (2001). For a covenant not to compete to be enforceable in this context, goodwill must be transferred; thus, there must be a clear indication that in the sales or redemption transaction, the parties valued or considered goodwill as a component of the sales price. *Id.* To determine whether goodwill transferred:

[A]ll aspects of the sales arrangement should be evaluated. For example, the entire structure of the transaction, including the sales price, might suggest that it can be said that goodwill had transferred. Additionally, such a conclusion might be reached because the seller has a significant economic investment. Evidence that the amount paid to the departing or selling shareholder approximates the amount the shareholder was expected to lose, as a result of the covenant not to compete, may be strong indicia that the sales price was intended to include goodwill so as to invoke the exception of section 16601. Further, if fair market value is paid for the shares, it may indicate that goodwill is part of the transaction, as an inference can be made that the price includes a value for goodwill. *Id.*, at 904.

The sales of stock must also involve “a substantial interest in the corporation so that the owner, in transferring all of his shares, can be said to transfer the goodwill of the corporation.” *Id.* at 904, citing *Bosley Med. Group v. Abramson*, 161 Cal. App. 3d 284, 290 (1984). At least one court has recognized that a three-percent holding in an entity priced at \$23 million was a substantial interest. *Vacco Indus. v. Van Den Berg*, 5 Cal. App. 4th 34, 38-39 (1992).

## **III. GENERAL COMMENTS:**

- A. Protectable interests:** Goodwill, as protected through the exceptions set forth in Business and Professions Code Sections 16601-16602.5, described above; fair competition, including protection of confidential and trade secret information (*see e.g., American Credit Indemnity Co. v. Sacks*, 213 Cal. App. 3d 622, 630-32 262 Cal. Rptr. 92, 98 (1989) (trade secret client information); *Readylink Healthcare v. Cotton*, 126 Cal. App. 4th 1006, 1022 (2005) (client and employee information; “we note that ‘if a former employee uses a former employer’s trade secrets or otherwise

commits unfair competition, California courts recognize a judicially created exception to section 16600 and will enforce a restrictive covenant in such a case”) and prevention of employee “raiding” and commensurate workplace disruption (see, e.g., *Loral Corp. v. Moyaes*, 174 Cal. App. 3d 268, 276-280 (1985)).

- B. Blue pencil/modification:** California courts will not reform a void and unenforceable noncompete covenant in the employment context. *Kolani v. Gluska*, 64 Cal. App. 4th 402, 408 (1998) (refusing to reform, despite savings provision in agreement). In the sale of business context, however, courts have blue penciled covenants to narrow and make enforceable the restrictive covenant. See, e.g., *Mahlstedt v. Fugit*, 79 Cal. App. 2d 562, 566-567, 180 P.2d 777, 779 (1947). “[T]he rule of severability may be evoked to uphold the covenant to the extent that it falls within the limits permitted by statute.” *Roberts v. Pfefer*, 13 Cal. App. 3d 93, 98 (1970). Compare *Swenson v. File*, 475 P.2d 852, 856 (Cal. 1970) (invoking severability to impose more narrow geographical limitation) with *Weber, Lipshie & Co. v. Christian*, 52 Cal. App. 4th 645, 658 n.6 (1997) (in dicta, refusing to blue pencil agreement which lacked any geographic restriction and distinguishing *Swenson* on that ground).
- C. Enforceability of “clawbacks” and other forfeitures of benefits:** The California Supreme Court “invalidated an otherwise narrowly tailored agreement as an improper restraint under section 16600 because it required a former employee to forfeit his pension rights on commencing work for a competitor.” *Edwards*, 189 P.3d at 291 (citing *Muggill v. Reuben H. Donnelley Corp.*, 398 P.2d 147, 149 (Cal. 1965) and *Chamberlain v. Augustine*, 156 P. 479, 480 (1916)).
- D. Is a noncompete covenant enforceable if the employee is discharged?**

If the noncompete covenant falls within an exception to section 16600, the noncompete, which was obtained in exchange for purchase of stock, remains enforceable notwithstanding the employee’s termination, even where the termination may be wrongful. *Vacco Indus.*, 5 Cal. App. 4th at 47-49.

- E. Will a choice of law provision in a contract be followed?**

Depends. “When a contract provides a choice of law other than California law, its enforcement involved a two-step analysis: (1) the foreign law must bear some substantial relationship to the parties or the contract and (2) application of the foreign law must not violate a strong public policy of California. *Weber*, 52 Cal. App. 4th at 658 (citing *Nedlloyd Lines B.V. v.*

*Superior Court*, 3 Cal. 4th 459, 479, 834 P.2d 1148, 1160-63 (1992)). Because section 16600 reflects strong public policy of California, courts typically apply California law to employment-related transactions involving a California party. See, e.g., *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881, 885 (1998) (applying California law over Maryland choice of law provision; “California law may be applied to determine the enforceability of a covenant not to compete, in an employment agreement between an employee who is not a resident of California and an employer whose business is based outside of California, when a California-based employer seeks to recruit or hire the nonresident for employment in California”); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 673 (1971) (applying California law notwithstanding New York choice of law provision contained in employment contract).

**F. Trade secrets defined:** Cal. Civ. Code § 3426.1.

**G. Statutory limitations within the legal industry:** Rule 1-500(A) of the Rules of Professional Conduct of the California State Bar prohibits attorneys licensed to practice in California from being “a party to . . . an agreement . . . if the agreement restricts the right of the member to practice law.” That rule, however, does not prohibit attorneys from agreeing to pay former partners or members of a corporation liquidated damages in the event of competition, assuming the agreement otherwise comes within an exception to section 16600. *Howard v. Babcock*, 863 P.2d 150 (Cal. 1993).

## COLORADO

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## COLORADO

### **I. STATUTORY AUTHORITY**

Colorado has a statute governing agreements not to compete. Colo. Rev. Stat. 8-2-113.

The statute states:

8-2-113. Unlawful to intimidate worker—agreement not to compete

- A.** It shall be unlawful to use force, threats, or other means of intimidation to prevent any person from engaging in any lawful occupation at any place he sees fit.
- B.** Any covenant not to compete which restricts the right of any person to receive compensation for performance of skilled or unskilled labor for any employer shall be void, but this subsection (2) shall not apply to:
  - 1. Any contract for the purchase and sale of a business or the assets of a business;
  - 2. Any contract for the protection of trade secrets;
  - 3. Any contractual provision providing for recovery of the expense of educating and training an employee who has served an employer for a period of less than two years;
  - 4. Executive and management personnel and officers and employees who constitute professional staff to executive and management personnel.
- C.** Any covenant not to compete provision of an employment, partnership, or corporate agreement between physicians which restricts the right of a physician to practice medicine, as defined in section 12-36-106, C.R.S., upon termination of such agreement, shall be void; except that all other provisions of such an agreement enforceable at law, including provisions which require the payment of damages in an amount that is reasonably related to the injury suffered by reason of termination of the agreement, shall be enforceable. Provisions which require the payment of damages upon termination of the agreement may include, but not be limited to, damages related to competition.

### **II. SUMMARY OF LAW**

Colorado prohibits all covenants not to compete unless the covenant falls within

one of four categories: (1) it is related to the sale or purchase of a business; (2) it is related to the protection of trade secrets; (3) it relates to the recovery of training expenses of an employee employed for less than two years; and (4) it relates to executive or management employees or their professional staff. None of these exceptions apply to independent contractors.

### III. ELEMENTS OF ENFORCEABILITY

#### A. Protectable Interest

To fit within the trade secret exception, the purpose of the covenant must be the protection of trade secrets and the covenant must be reasonably limited in scope to protect those trade secrets. *Gold Messenger v. McGuay*, 937 P.2d 907, 910 (Colo. Ct. App. 1997). When determining whether information is a trade secret, Colorado courts look at six factors: (1) the extent to which the information is known outside the business; (2) the extent to which it is known to those inside the business; (3) the precautions taken to guard the secrecy of the information; (4) the saving effected and value to the holder in having the information against competitors; (5) money and effort spent in obtaining and developing the information; and (6) money and effort it would require others to develop or acquire the same information. *Porter Industries v. Higgins*, 680 P.2d 1339, 1341 (Colo. Ct. App. 1984).

#### B. Executive and Management Personnel, Officers, and Employees who Constitute Professional Staff

The determination of whether an employee falls within the executive and management personnel exception is generally a fact question for the court. *Porter Industries, Inc. v. Higgins*, 680 P.2d 1339, 1342. Courts have limited the phrase "professional staff to executive and management personnel" to those persons who, while qualifying as "professionals" and reporting to managers or executives, primarily serve as key members of the manager's or executive's staff in the implementation of management or executive functions. *Phoenix Capital, Inc. v. Dowell*, 176 P.3d 835 (Colo. Ct. App. 2007). Courts require that the employee must be able to act in an unsupervised manner and/or manage and supervise other employees. See *Porter*, 680 P.2d at 1342 (employee who did not exercise control over the employer's contracts and did not act in unsupervised manner was not management or executive personnel); *Atmel Corp. v. Vitesse Semiconductor Corp.*, 30 P.3d 789, 795 (Colo. Ct. App. 2001) (technical liaison who had no managerial or supervisory duties and had several levels of management above him was not management or executive personnel); *Management Recruiters of Boulder v. Miller*, 762 P.2d 763 (Colo. Ct. App. 1988) (a headhunter account executive whose

primary duty was gathering information was not executive or management personnel). In *Smith v. Sellers*, 747 P.2d 15 (Colo. App. 1987), a Court found that a restrictive covenant was void because the employment contract stated that covenantor was an independent contractor; therefore, the convenator could not be “staff.”

### **C. Reasonableness Requirements**

Even if the covenant not to compete falls within one of the statutory exceptions, Colorado courts also require that the covenant be reasonable as to time and territory. *National Graphics v. Dilley*, 681 P.2d 546 (Colo. App. 1984); *Electrical Distribs., Inc. v. SFR, Inc.*, 166 F.3d 1074 (10th Cir. 1999). The courts look at the facts and circumstances of each case to determine whether the restrictions are reasonable. *Zeff, Farrington & Assocs. v. Farrington*, 449 P.2d 813, 816 (Co. 1968). Colorado courts have found the restrictions reasonable in the following instances: *Gibson v. Angros*, 491 P.2d 87 (Colo. App. 1971) (five year, one county restriction on ophthalmologist was reasonable and enforceable); *Boulder Medical Center v. Moore*, 651 P.2d 464 (Colo. App. 1982) (doctor’s five year, one county covenant not to compete with hospital was enforceable since he sold his business and was a member of the professional staff, thus qualifying under two of the exceptions to the statute); *Management Recruiters of Boulder v. Miller*, 762 P.2d 763, 764-766 (Colo. App. 1988) (portion of contract restricting headhunter for one year from contacting potential candidates was enforceable under trade secret exception to statute); *In re Marriage of Fischer*, 834 P.2d 270 (Colo. App. 1992) (covenant not to compete imposed on husband in divorce proceeding which required him to transfer photographic developing business to wife and not to compete within twenty miles for three years was reasonable and fit within the sale of business and executive and management personnel exceptions to the statute).

Colorado courts have held that the following restrictions were unreasonable: *National Graphic Co. v. Dilley*, 681 P.2d 546 (Colo. App. 1984) (covenant not to compete without restrictions as to duration and geographic scope held to be void); *Colorado Accounting Machines v. Mergenthaler*, 609 P.2d 1125, 1126 (Colo. App. 1980) (portion of employment contract with covenant containing general noncompetition provision held void) (Colo. App. 1984); *Nutting v. RAM Southwest, Inc.*, 106 F.Supp.2d 1121 (D. Colo. 2000).

### **D. Consideration**

In Colorado, continued employment appears to be sufficient consideration. *Lampley v. Celebrity Homes, Inc.*, 594 P.2d 605, 608 (Colo. App. 1979);

*Olsen v. Bondurant and Co.*, 759 P.2d 861 (Colo. App. 1988); *but see Rivendell Forest Products, Ltd. v. Georgia-Pacific Corp.*, 824 F.Supp. 961, 968 (D. Colo. 1993) (court holds that confidentiality agreement was void for lack of consideration where “there was no evidence that [the employee] received anything—higher wages, a promotion, access to technical aspects of [the old employer’s] system—as a result of his voluntary signing of the agreement”).

#### **IV. GENERAL COMMENTS**

##### **A. Court Reformation**

Colorado courts have the discretion to sever or reform an overbroad covenant to make it reasonable. *National Graphic Co. v. Dilley*, 681 P.2d 546 (Colo. App. 1984); *Management Recruiters of Boulder v. Miller*, 762 P.2d 763, 764-766 (Colo. App. 1988); *Colorado Accounting Machines v. Mergenthaler*, 609 P.2d 1125, 1126 (Colo. App. 1980).

##### **B. Choice of Law Provisions**

Colorado courts will generally honor choice of law provisions unless (1) the chosen state does not have any relationship to the parties and the transactions; or (2) the law of the chosen state is against a fundamental policy of Colorado. A choice of law provision that selects a state that would find a covenant not to compete valid when the covenant would be invalid under Colorado law may be against a fundamental policy of Colorado and, therefore, unenforceable. *See Dresser Industries v. Sandvick*, 732 F.2d 783 (10<sup>th</sup> Cir. 1984). If the chosen state’s law does not conflict with Colorado law, the courts will enforce a choice of law provision. *King v. PA Consulting Group, Inc.*, 485 F.3d 577, 589 (10th Cir. Colo. 2007).

##### **C. Enforceability if Employee Terminated**

While a Colorado court has not expressly addressed this issue, it appears that Colorado courts will enforce covenants not to compete against employees who have been terminated. *See Management Recruiters of Boulder v. Miller*, 762 P.2d 763 (Colo. Ct. App. 1988) (covenant enforced against employee terminated for undependability).

##### **D. Forfeiture Provisions**

It is unclear whether Colorado courts will recognize all forfeiture provisions. However, the courts have enforced a provision in a deferred profit sharing plan that provided that the former employee would not be

entitled to future payments if the employee later engaged in a competitive line of work. *Collister v. Board of Trustees of McGee Company Profit Sharing Plan*. 531 P.2d 989 (Colo. Ct. App. 1975).

#### **E. Attorney's Fees**

Colorado courts have not addressed the issue of whether attorney's fees are recoverable in a covenant not to compete case. However, Colorado only allows for the awarding of attorney's fees if they are provided for in a statute, court rule or private contract in a contract action. *Berhard v. Farmer's Insurance Exchange*, 915 P.2d 1285, 1287 (Co. 1996). Therefore, it is unlikely that attorney's are recoverable in a suit to enforce a covenant not to compete.

## CONNECTICUT

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## CONNECTICUT

### I. SUMMARY OF THE LAW

"In order to be valid and binding, a covenant which restricts the activities of an employee following the termination of his employment must be partial and restricted in its operation "in respect either to time or place . . . and must be reasonable that is, it should afford only a fair protection to the interest of the party in whose favor it is made and must not be so large in its operation as to interfere with the interests of public."

The interests of the employee himself must also be protected, and a restrictive covenant is unenforceable if by its terms the employee is precluded from pursuing his occupation and thus prevented from supporting himself and his family.

Connecticut courts will consider five factors in determining the reasonableness of a covenant not to compete: "(1) the length of time the restriction is to be in effect; (2) the geographic area covered by the restriction; (3) the degree of protection afforded the party in whose favor the covenant is made; (4) the restriction on the employee's ability to pursue his occupation; and (5) the extent of interference with the public's interests."

Scott v. General Iron & Welding Co., 368 A.2d 111, 114 15 (Conn. 1976) (citations omitted); see also Connecticut Uniform Trade Secrets Act, C.G.S.A. § 35 50 to § 35 58 (1993); New Haven Tobacco Co. v. Perrelli, 528 A.2d 865, 868 (Conn. App. 1987) (cited in Pediatric Occupational Therapy Services, Inc. v. Town of Wilton et al, 2004 Conn. Super. LEXIS 893, \*27).

The second prong of the test, the geographic scope, is not the deciding factor in and of itself. The general rule is that the application of a restrictive covenant will be confined to a geographical area which is reasonable in view of a particular situation. A restrictive covenant which protects the employer in areas in which he does not do business or is unlikely to do business is unreasonable with respect to the area. Scott v. General Iron & Welding Co., 171 Conn. 138 (1976).

Under the fifth prong of the Scott test, in determining whether a covenant interferes with the public's interest, a Connecticut court will consider three factors: "(1) the scope and severity of the covenant's effect on the public interest; (2) the probability of the restriction creating or maintaining an unfair monopoly in the area of trade; and (3) the interest sought to be protected by the employer." New Haven Tobacco Co. v. Perrelli, 528 A.2d 865, 868 (Conn. App. 1987).

Furthermore, "the five-pronged test is disjunctive; a finding of unreasonableness in any one of the criteria is enough to render the covenant unenforceable." New

Haven Tobacco Co. v. Perrelli, 528 A.2d 865, 867 (Conn. App. 1987).

## II. PARAMETERS OF THE "REASONABLENESS" TEST

### A. Ancillary to an employment contract.

Geographic restrictions should be "narrowly tailored to the employer's business situation." *Braman Chemical Enterprises, Inc. v. Barnes*, 2006 Conn. Super. Lexis 3753, \*9. Regarding time periods, a non-compete agreement may provide for a sufficient period of time for an employer to restaff his sales force to cover customers of the former employer and to secure the goodwill of those customers. *Van Dyck v. DiNicola*, 43 Conn.Sup. 191 (1993). Connecticut courts have tended to apply greater scrutiny to non-compete agreements that create general bars based on geographical considerations than to anti-sales provisions, which prevent a former employee from transacting business with his former employer's customers. See *Robert S. Weiss & Associates, Inc. v. Wiederlicht*, 546 A.2d 216 (1988).

#### 1. Covenants held reasonable:

*United Rentals, Inc. v. Bastanzi*, 2005 U.S. Dist. LEXIS 45268 (D. Conn. 2005) (upholding a one-year restriction encompassing a seventy-five mile radius because the area accurately captured the market serviced by the employer and was therefore precisely drawn to protect the employer's good will); *Robert S. Weiss & Assocs., Inc. v. Wiederlicht*, 546 A.2d 216 (Conn. 1988) (upholding ten-mile radius restriction with areas carved out where the employee was free to practice his trade); *Scott v. General Iron & Welding Co.*, 368 A.2d 111 (Conn. 1976) (five year statewide covenant barring employee from working as *manager* in competing business was reasonable); *Roessler v. Burwell*, 176 A. 126 (Conn. 1934) (covenant which restricted solicitations from customers of the former employer in a specific locality upheld); *KX Industries v. Saaski*, 1997 Conn. Super. LEXIS 2444 (restriction containing no geographic boundaries upheld because limited to four direct competitors); *Maintenance Technologies International, LLC v. Vega*, 2006 Conn. Super. LEXIS 136, \*2, \*10 (court granted temporary injunction to enforce two-year, 150-mile covenant not to compete because plaintiff's employees and its customer relationships were plaintiff's most valuable assets, and restrictive covenant provided fair and reasonable degree of protection to plaintiff); *Access America, LLC v. Mazzotta*, 2005 Conn. Super. LEXIS 2597, \*1, \*12-13 (court granted temporary injunction to enforce fifteen-mile covenant not to compete for one year); *Kim's*

*Hair Studio, LLC v. Rogers*, 2005 Conn. Super. LEXIS 1805, \*2, \*8 (court granted temporary injunction to enforce one-year, ten-mile covenant not to compete; *Edge Technology Services, Inc. v. Worley*, 2005 Conn. Super. LEXIS 1804, \*8, \*22, \*25 (court granted temporary injunction to enforce one-year covenant not to compete covering any client of employer); *Piscitelli v. Pepe*, 2004 Conn. Super. LEXIS 3264 (court granted temporary injunction to enforce one-year covenant not to compete spanning four towns); *Riordan v. Barbosa*, 1999 Conn. Super LEXIS 446 (five-year restriction against soliciting or servicing any then-existing clients of accounting partnership upheld).

2. *Covenants held unreasonable:*

*Samuel Stores. Inc. v. Abrams*, 108 A. 541 (Conn. 1919) (five-year covenant barring sales in "any city" where employer operated found invalid); *Timenterial, Inc. v. Dagata*, 277 A.2d 512 (Conn. Super. Ct. 1971) (bar covering areas within fifty miles from any of employer's locations in five states unreasonable; one-year time limit reasonable); *Braman Chemical Enterprises, Inc. v. Valerie Barnes*, 2006 Conn. Super. Lexis 3753 (50-mile radius unreasonable because substantially more than necessary to provide protection of employer's business, 6-month time limit reasonable); *Sanford Hall Agency, Inc. v. Dezanni*, 2004 Conn. Super. LEXIS 3574, \*4-5, \*8-10 (court refused to grant temporary injunction to enforce two-year restrictive covenant prohibiting employee from canvassing, soliciting or accepting business for any other employer insurance agency, from any present or past clients; giving any other person, firm or corporation the right to canvass, solicit or accept any business for any other insurance agency, from any present or past clients; directly or indirectly disclosing to any other person, firm or corporation the names of past, present or future clients of the agency; or directly or indirectly inducing or attempting to influence any employee of the agency to terminate his or her employment because the restriction was overbroad and therefore not enforceable); *Grayling Associates, Inc. v. Villota*, 2004 Conn. Super. LEXIS 1859 (one hundred-mile radius restriction was unreasonable; 2 year time period reasonable); *Century 21 Access America v. Lisboa*, 2003 Conn. Super. LEXIS 2085 (two-year restriction found unreasonable when it was shown that plaintiff real estate agency's average customer listing lasted only six months and there was little repeat business; court also noted that plaintiff is not required to demonstrate that it does business in each and every town that is within the geographic area proscribed by the covenant);

*Cost Management Incentives, Inc. v. London-Osborne*, 2002 Conn. Super. LEXIS 3967 (in the context of the “fast moving nature of the biotechnology market” a two-year anti-solicitation covenant found overreaching and unnecessary to protect employer’s position to withstand competition from former employees); *Ranciato v. Nolan*, 2002 Conn. Super. LEXIS 489 (three-year, three-state restriction on building restorer was not “reasonably limited” and court refused to “blue pencil” the restrictive covenant when no evidence was presented to establish appropriate boundaries of protection); *RKR Dance Studios v. Makowski*, 2008 Conn. Super. LEXIS 2295 (non-compete preventing employee from working for two years as dance instructor within fifteen miles of employer or within ten miles of any of the same franchise’s dance studios was unreasonable).

## **B. Incidental to the sale of a business.**

Connecticut courts are generally more willing to uphold restrictions in cases involving the sale of a business than in cases between employees and employers. See *Samuel Stores, Inc. v. Abrams*, 94 Conn. 248 (1919) (explaining the difference based on the fact that restrictions related to the transfer of a business add value to both parties, the parties in a business transfer are more likely equals in negotiation ability, and there is a large scope for freedom of contract in negotiations between experienced businesspersons).

### **1. Covenants held reasonable:**

*Leo’s Partners, LLC v. Ferrari*, 2005 Conn. Super. LEXIS 3595 (20-mile restriction in connection with sale of a family restaurant upheld); *Kim’s Hair Studio, LLC v. Rogers*, 2005 Conn. Super. LEXIS 1805 (upholding 10-mile restriction in connection with sale of beauty salon); *Sagarino v. SCI Connecticut Funeral Services, Inc.*, 2000 Conn. Super. LEXIS 1384 (30-mile restriction in connection with sale of family-owned funeral home upheld); *Musto v. Opticare Eye Health Centers, Inc.*, 2000 Conn. Super. LEXIS 2298 (agreement not to compete incidental to sale of ophthalmology business which prohibited competition for eighteen months within a fifteen-mile radius held reasonable); *Mattis v. Lally*, 82 A.2d 155 (Conn. 1951) (agreement not to compete incidental to sale of barber shop prohibiting competition in one city (or a one-mile radius of the barber shop) for five years held reasonable); *Milaneseo v. Calvanese*, 103 A. 841 (Conn. 1918) (covenant incidental to sale by part owner of his interest in a fruit, ice cream and vegetable business prohibiting competition in the same town for three years found reasonable).

### III. GENERAL COMMENTS

- A. Protectible interests:** sale of goodwill, customer contacts, disclosure of trade secrets, including client and customer lists, formulas and other information. See *Robert S Weiss & Assocs., Inc. v. Wiederliht*, 546 A.2d 216 (Conn. 1988); *Scott v. General Iron & Welding Co.*, 368 A.2d 111 (Conn. 1976); *May v. Young*, 125 Conn. 1, 6-7 (1938) (“Especially if the employment involves the imparting of trade secrets, methods or systems and contacts and associations with clients or customers it is appropriate to restrain the use, when the service is ended, of the knowledge and acquaintance, so acquired, to injure or appropriate the business which the party was employed to maintain and enlarge. The employer is entitled to contract for and to enforce protection against unfair competition . . . such as the knowledge of trade secrets or other confidential information or an acquaintance with his employer's customers and their requirements, resulting from the nature of the employee's services, which is regarded as a species of good will in which the employer has a proprietary interest.”). See also *Sagarino v. SCI Connecticut Funeral Services, Inc.*, 2000 Conn. Super. LEXIS 2298 (court upheld as reasonable agreement incidental to sale of funeral home which restricted competition within a thirty-mile radius for fifteen years, noting that the personal nature of the funeral business made the longer duration reasonable to protect the good will purchased); *Entex Information Services, Inc. v. Behrens*, 2000 Conn. Super. LEXIS 744 (where employees were of an extremely low skill level and possessed no skills that were not easily duplicated by other firms, an intention to hold an employee for no other purpose than to prevent that employee from working for another competitor is unreasonable and the covenant not to compete was not enforced).
- B. Covenant Reformation:** If a covenant is overbroad it can be enforced insofar as is reasonable, if the parties have evidenced an intent to make the covenant severable. A court may use the “blue pencil” rule to reform an unreasonable restriction only if a “grammatically meaningful reasonable restriction remains after the words making the restriction unreasonable are stricken.” *Deming v. Nationwide Mut. Ins. Co.*, 279 Conn. 745 (2006) (citing *A.N. Deringer, Inc. v. Strough*, 103 F.3d 243, 247 (2d Cir. 1996)); *Gartner Group Inc. v. Mewes*, 1992 WL 4766 (Conn. Super. Ct. Jan. 3, 1992) (courts will “blue pencil” a contract when a covenant “contains or may be read as containing several distinct undertakings bounded by different limits of time or space, different in subject-matter” such that it is severable). See also *Beit v. Beit*, 135 Conn. 195 (1948) (refusing to reform a covenant not to compete in an entire county to make it reasonable where the parties did not separately identify localities that could be penciled out); *Timenterial, Inc. v. Dagata*, 277 A.2d 512 (Conn.

Super. Ct. 1971); *Century 21 Access America v. Lisboa*, 2003 WL 21805547 (Conn. Super. Ct. 2003) (parties' intent that unreasonable time limit in restrictive covenant be severable found in covenant language and more reasonable time limit of one year imposed by court to preserve the covenant).

- C. Consideration:** Continued employment alone is not usually sufficient consideration. See *Timenterial, Inc. v. Dagata*, 277 A.2d 512, 515 (Conn. Super. Ct. 1971); *Lester Telemarketing v. Pagliaro*, 1998 Conn. Super. LEXIS 2483. However, when the employee is presented with a non-compete agreement after commencing work, but where the parties have not concluded an agreement encompassing all of the terms of employment, continued employment may be sufficient consideration. *Van Dyck Printing Co. v. DiNicola*, 648 A.2d 898 (1993). See also *Torrington Creamery, Inc. v. Davenport*, 12 A.2d 780 (Conn. 1940) (where employer hired employee to work in a different capacity than his previous position, there was sufficient consideration to enforce a covenant not to compete); *Weseley Software Development Corp. v. Burdette*, 977 F.Supp. 137 (D. Conn. Dec. 1996) (consideration for covenant not to compete found in employment agreement was established by continued employment, an articulated paid vacation entitlement and a new entitlement to severance benefits and stock option.)

On the other hand, when the employee is terminable at will, continued employment is generally considered sufficient consideration. *RKR Dance Studios, Inc. v. Makowski*, 2008 Conn. Super. LEXIS 2295 (summarizing several cases holding both that continued employment is and is not sufficient consideration). See Also *Blum, Shapiro & Company, P.C. v. Searles & Houser, LLC*, 1999 Conn. Super. LEXIS 2261 (when a pre-existing contract of employment is terminable at will, no overt consideration is required to support an otherwise valid covenant not to compete. The law presumes that such a covenant is supported by the employer's implied promise to continue the employee's employment or his forbearance in not discharging the employee then and there); *KX Industries v. Saaski*, 1997 Conn. Super. LEXIS 2444 (when determining whether a restrictive covenant in the employment context is supported by sufficient consideration, the court must consider the temporal proximity between the employee's hiring and the signing of the employment agreement. Moreover, where a preexisting contract of employment is terminable at will, no overt consideration is required to support an otherwise valid covenant not to compete).

- D. Employee discharged:** The reasonableness of a non-compete covenant does not turn on whether the employee left voluntarily or was involuntarily

discharged. *Robert S. Weiss & Assocs., Inc. v. Wiederlight*, 546 A.2d 216, 221 (Conn. 1988). See also *Gartner Group Inc. v. Mewes*, 1992 WL 4766 (Conn. Super. Ct. Jan. 3, 1992); *Simcic v. G&W Management, Inc.*, 2000 Conn. Super. LEXIS 3271 (after offer of at-will employment was accepted, the employee refused to sign a non-competition agreement and was terminated. The court held that the employee had no valid claim of violation of public policy for the termination).

- E. Attorneys' fees:** Attorneys' fees are generally not recoverable unless specified in contract or available by statute. The Connecticut version of the Uniform Trade Secrets Act provides, "if a claim of misappropriation is made in bad faith or if a motion to terminate an injunction is made or resisted in bad faith, the court may award reasonable attorneys' fees to the prevailing party." C.G.S.A. § 35-54.
  
- F. Employer's breach:** Employer's breach of employment agreement will generally relieve employee of contractual obligation not to compete if the breach was material and the employee has not waived the breach. See *Van Dyck Printing Co. v. Denicola*, 1993 Conn. Super. LEXIS 2054 (the court enforced a restrictive covenant where the employer's breach was not material).
  
- G. Choice of law:** The courts of Connecticut have adopted the rules on conflict of laws set forth in the Restatement of the Law, and under these rules, substantial weight and deference is required to be given to the parties' choice of law. However, the parties' choice of another state's law will be disregarded if either: (1) the other state has no substantial relationship to the parties or transaction and there is no other reasonable basis for the parties' choice; or (2) the application of the other state's law would be contrary to a fundamental policy of Connecticut and Connecticut has a materially greater interest in the matter than the other state. *Industrial Technologies, Inc. v. Paumi*, 1997 Conn. Super. LEXIS 1499. See also *Custard Insurance Adjusters, Inc. v. Nardi*, 2000 Conn. Super. LEXIS 1003 (holding that even though Massachusetts law applied to the contract, Connecticut's Uniform Trade Secrets Act and Unfair Trade Practices Act both reflected important public policy considerations and should be applied). Furthermore, specifically concerning the enforcement of non-compete agreements, it has been held that even where a choice of law clause dictates that the law of a foreign state will apply, a court will apply the law of the forum state (i.e. the locality test) in determining the propriety and extent of injunctive relief under the agreement and as to all theories of liability against the parties. *Id.* (evaluating the contract interpretation issues and breach of contract claims using Massachusetts

law and evaluated the reasonableness of the restriction using Connecticut law).

- H. **Trade Secrets defined:** “A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound . . . or a list of customers.” *Robert S. Weiss & Assocs., Inc. v. Wiederlight*, 546 A.2d 216, 223-24 (Conn. 1988) (citing the Restatement, Torts § 757, comment b); C.G.S.A. § 35-54(d). A customer list may be a trade secret, and an employee prevented from using it, if the employee obtained the list in confidence and it is not available publicly. Id.
- I. **Forfeiture clauses:** A contractual forfeiture clause, under which deferred compensation accrued under an agency security compensation plan is forfeited if employee engages in competing business, does not differ meaningfully from a covenant not to compete, and therefore must be subjected to the same reasonableness test as covenants not to compete. See *Deming v. Nationwide Mutual Insurance Company*, 279 Conn. 745, 767-69 (2006). See also *Schoonmaker v. Cummings and Lockwood of Connecticut*, 252 Conn. 416 (2000) (employment agreement for a law firm partner contained a non-competition provision that stated that post-employment benefits were conditioned upon the former partner not practicing law for three years within three counties in Connecticut as well as certain counties in Florida where the firm had offices. The court upheld this provision and stated that it did not violate the public policy set forth in the Connecticut Rules of Professional Conduct prohibiting an attorney from subscribing to a restrictive practice agreement).
- J. **Noteworthy articles and/or publications:** Lips, Non-Competition Clauses in Employment Contracts, 60 Conn. B. J. 369 (1986); Employee Covenants in CT, NJ and PA – Watch Out New Yorkers!, 1233 PLI/Corp 107 (2001).
- K. **Noteworthy cases summarizing scope of permissible/impermissible restraints:** *Robert S. Weiss & Assocs., Inc. v. Wiederlight*, 546 A.2d 216 (Conn. 1988); *New Haven Tobacco Company v. Perrelli*, 528 A.2d 865 (Conn. App. 1987); *Braman Chemical Enterprises, Inc. v. Barnes*, 2006 Conn. Super. Lexis 3753, \*9; *KX Industries v. Saaski*, 1997 Conn. Super. LEXIS 2444; *Aetna Retirement Services, Inc. v. Hug*, 1997 Conn. Super. LEXIS 1781.

## DELAWARE

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## DELAWARE

### I. JUDICIAL STATEMENT OF THE LAW

“In the case of *Capital Bakers v. Leahy* . . . this Court noted that Delaware recognized the general validity of restrictive covenants in employment contracts, stating:

‘Whatever might have been the early rule on the subject, it is now too well settled to be disputed that an agreement by an employee not to follow his trade or business for a limited time and during a limited period is not void as against public policy, when the purpose of the agreement and its reasonable operation is to protect his employer from the injury which the employee’s subsequent activity in the way of trade may occasion.’

This principle is qualified; however, by the further rule that where a sale of a business is not involved, courts should be less prone to enforce such covenants.”

*Knowles-Zeswitz Music, Inc. v. Cara*, 260 A.2d 171, 174-75 (Del.Ch. 1969) (quoting *Capital Bakers, Inc. v. Leahy*, 178 A. 648 (Del.Ch. 1935)); see also *Lewmor, Inc. v. Fleming*, 1986 WL 1244, 12 Del. J. Corp. L. 292 (Del.Ch. 1986) (Delaware courts balance the harm to the former employee of enforcing the covenant, whether the employer will suffer harm from the employee’s breach and any harm to the public.); see also *Faw, Casson & Co. v. Cranston*, 375 A.2d 463, 465 (Del. Ch. 1977) (“[C]ovenants are subject to somewhat greater scrutiny when contained in an employment contract as opposed to contracts for the sale of a business.”); *TriState Courier and Carriage, Inc. v. Berryman*, No. C.A. 20574, 2004 WL 835886, at \*10 (Del. Ch. Apr. 15, 2004) (inquiry into enforceability of covenant in contract for sale of stock “is less searching than if the Covenant had been contained in an employment contract.”).

“In order for a covenant not to compete to be enforceable, it must (1) meet general contract law requirements, (2) be reasonable in scope and duration, (3) advance a legitimate economic interest of the party enforcing the covenant, and (4) survive a balance of the equities.” *TriState Courier and Carriage, Inc.*, 2004 WL 835886, at \*10 (citing *Del. Express Shuttle, Inc. v. Older*, No. 19596, 2002 WL 31458243, at \*11 (Del. Ch. Oct. 23, 2002); *Research & Trading Corp. v. Pfuhl*, 1992 WL 345465, at \*11 (Del. Ch. Nov. 18, 1992)).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract

1. *Del. Express Shuttle, Inc. v. Older*, No. 19596, 2002 WL 31458243 (Del. Ch. 2002) (covenants restricting future employment must be reasonably limited in geography and time and address a legitimate economic interest of the employer); *McCann Surveyors, Inc. v. Evans*, 611 A.2d 1 (Del. Ch. 1987) (three-year, 50-mile radius restriction was reasonable, but specific enforcement was denied after court balanced the relative injuries to the parties); *Faw, Casson & Co. v. Cranston*, 375 A.2d 463 (Del. Ch. 1977) (three-year bar limited to peninsula where employee-accountant's former partnership had offices found reasonable).
2. *John Roane, Inc. v. Tweed*, 89 A.2d 548 (Del. 1952) (court reduced five-year restriction on insurance adjuster to four years); *Elite Cleaning Co. v. Capel*, No. Civ. A. 690, 2006 WL 1565161, at \*8-9 (Del. Ch. June 2, 2006) (finding two-year restriction unreasonable for an unskilled worker and suggesting that any restriction would be unreasonable if imposed on an unskilled worker with no special knowledge or training); *Caras v. American Original Corp.*, No. 1258, 1987 Del. Ch. LEXIS 467 (July 31, 1987) (geographic restrictions in areas where employer does not operate were unenforceable).

#### **B. Incidental to the sale of a business**

1. *Turek v. Tull*, 139 A.2d 368 (Del. Ch.), *aff'd*, 147 A.2d 658 (Del. 1958) (promise by seller of nursing home not to operate a sanitarium in the county for ten years was reasonable).

### **III. GENERAL COMMENTS**

- A. Protectable interests: Customer contacts, goodwill, business secrets (including customer lists), relationships with employees. See *Knowles-Zeswitz Music, Inc. v. Cara*, 260 A.2d 171 (Del.Ch. 1969); *Original Vincent & Joseph, Inc. v. Schiavone*, 134 A.2d 843 (Del.Ch. 1957); *Weichert Co. of Pa. v. Young*, C.A. No. 2223, 2007 WL 4372823, at \*3-4 (Del. Ch. Dec. 7, 2007) (finding legitimate business interest in protecting relationships with employees because of considerable resources expended in training employees); *see also Hammermill Paper Co. v. Palese*, No. 7128, 1983 Del. Ch. LEXIS 400 (Del. Ch. June 14, 1983); *Elite Cleaning Co. v. Capel*, No. Civ. A. 690, 2006 WL 1565161, at \*7-8 (Del. Ch. June 2, 2006) (employer has legitimate interest in preventing “disintermediation” (i.e., elimination of the “middleman” employer by the employer’s clients directly hiring the employer’s workers), but that interest is very weak for unskilled workers).

- B.** If covenant is overbroad, it may be enforced only to the extent reasonable. See, e.g., *Knowles-Zeswitz Music, Inc. v. Cara*, 260 A.2d 171 (Del. Ch. 1969) (rejecting the "blue pencil test").
- C.** In appropriate circumstances, a court may enforce an agreement without express territorial scope and establish a reasonable geographic limitation. *Del. Express Shuttle, Inc. v. Older*, No. 19596, 2002 WL 31458243 (Del. Ch. 2002). For example, in *Research & Trading Corp. v. Pfuhl*, No. 12527, 1992 WL 345465 (Del. Ch. Nov. 19, 1992), the court concluded that the widespread goodwill of the plaintiff and the limited nature of relief sought by the plaintiff rendered the covenant reasonable as written (without any geographical restriction) and the court refrained from restricting the agreement's geographic scope.
- D.** The scope of activities prohibited by a noncompetition agreement may be unenforceable as vague or overbroad. For example, the Delaware Court of Chancery refused to enforce a provision of a non-competition agreement that prohibited a former employee from engaging in activities "similar to" his former employer, but enjoined the former employee from engaging in activities "competitive with" the former employer. *Del. Express Shuttle, Inc. v. Older*, No. 19596, 2002 WL 31458243 (Del. Ch. Oct. 23, 2002). The court viewed such prohibitions on activities "similar to" the employer to be unenforceable as an unduly expansive range of activities when not accompanied by a territorial limit in the agreement. *Id.* at \*50; see also *EDIX Media Group, Inc. v. Mahani*, No. Civ. A. 2186, 2006 WL 3742595, at \*8 (Del. Ch. Dec. 12, 2006) (finding that preventing independent contractors from engaging in any activities "substantially similar" to plaintiff's activities may force an independent business out of an industry, suggesting strongly "that enforcement of 'substantially similar' provisions in non-competition clauses will be both inequitable to the contractor and against public policy" (citing *Del. Express Shuttle*, 2002 WL 31458243)).

Such restrictions, however, are enforceable when accompanied by territorial restrictions. In *TriState Courier and Carriage, Inc. v. Berryman*, No. C.A. 20574, 2004 WL 835886 (Del. Ch. Apr. 15, 2004), the court considered covenants in a stock purchase agreement in which a former employee sold stock back to his former employer. The court enforced covenants prohibiting the former employee from providing services "substantially similar" to those provided by the former employer within the geographic region where the employer conducted business, and prohibiting the former employee from soliciting the employer's customers for the purpose of providing services "reasonably substitutable" for the employer's services.

- E.** Continued employment for an at-will employee is sufficient consideration for a noncompetition covenant. See *Research & Trading Corp. v. Powell*, 468 A.2d 1301 (Del. Ch. 1983); *Comfort, Inc. v. McDonald*, 9 Del. J. Corp. L. 420 (Del. Ch. 1984); *Weichert Co. of Pa. v. Young*, C.A. No. 2223, 2007 WL 4372823, at \*3 (Del. Ch. Dec. 7, 2007); *All Pro Maids, Inc. v. Layton*, No. Civ. A. 058, 2004 WL 1878784, at \*3 (Del. Ch. Aug. 10, 2004). Other cases cite to promotions in evaluating consideration. See, e.g., *Faw, Casson & Co. v. Cranston*, 375 A.2d 463 (Del. Ch. 1977).
- F.** A forfeiture of benefits provision may be treated as a restraint of trade and thus subject to the same analysis as other noncompetition covenants. *Pollard v. Autotote, Ltd.*, 852 F.2d 67 (3d Cir. 1988), amended 872 F.2d 1131 (3d Cir. 1989).
- G.** Is a noncompete covenant enforceable if the employee is discharged? The law in Delaware is unclear. It appears however, that if the employer breaches the employment contract, by wrongfully discharging the employee, then the noncompete covenant will be unenforceable. See, e.g., *Caras v. Am. Original Corp.*, No. 1258, 1987 Del. Ch. LEXIS 467 (July 31, 1987) (Del. Ch. 1987) (where the court states that if the employee were terminated "at the wish of his employer," the restrictive covenant not to compete is no longer effective); *Caldwell Flexible Staffing, Inc. v. Mays*, No. 5204, 1976 Del. Ch. LEXIS 149 (Del. Ch. Nov. 26, 1976) (where the court made the enforceability decision based on the actions of the former employer which led the employees to believe their conduct post-termination would be acceptable).
- H.** Attorneys' fees may be recoverable if so provided by contract. See *Research & Trading Corp. v. Pfuhl*, No. 12527, 1993 Del. Ch. LEXIS 45 (Del. Ch. Feb. 26, 1993) (court reluctantly enforced contractual provision which allowed recovery for attorneys' fees).
- I.** Will employer's breach of employment agreement relieve employee of contractual obligations not to compete? Yes. See, e.g., *Knowles-Zeswitz Music, Inc. v. Cara*, 260 A.2d 171, 174 (Del. Ch. 1969); *Capital Bakers, Inc. v. Leahy*, 178 A. 648, 650-51 (Del. Ch. 1935).
- J.** Will choice of law provisions in contract be followed? Yes. See, e.g., *Cooper v. Ross & Roberts, Inc.*, 505 A.2d 1305 (Del. Super. Ct. 1986).
- K.** Trade secrets defined: See *Del. Code Ann.* tit. 6, § 2001(4) (2003).
- L.** An employer may be granted an injunction against a former employee who agreed either expressly or impliedly not to disclose trade secrets or other confidential information acquired in the course of employment. *E.I.*

*Dupont De Nemours & Co. v. Am. Potash & Chem. Corp.*, 200 A.2d 428, 431 (Del. Ch. 1964); see also *Horizon Personal Commc'ns, Inc. v. Sprint Corp.*, No. 1518, 2006 WL 4782361, at \* 20 (Del. Ch. Apr. 4, 2006) (“Damages would not adequately compensate Plaintiffs for a breach of the confidentiality provisions because the purpose of such provisions is to prevent harm and misuse before it occurs.”). In the absence of a covenant not to compete, an employee who achieves technical expertise or general knowledge from his former employer may later use that information in competition with his former employer, as long as trade secrets are not used or disclosed. *Rypac Packaging Mach. Inc. v. Coakley*, No. 16069, 2000 Del. Ch. LEXIS 64, \*37 (Del. Ch. May 1, 2000).

- M.** Noteworthy cases summarizing scope of permissible/impermissible restraints: *McCann Surveyors, Inc. v. Evans*, 611 A.2d 1 (Del. Ch. 1987); *Knowles-Zeswitz Music, Inc. v. Cara*, 260 A.2d 171 (Del. Ch. 1969).
- N.** A covenant not to compete provision found in an employment, partnership or corporate agreement restricting the area in which a physician may practice is void upon the termination of a principal agreement of which the provision is a part. *Del. Code Ann.* tit. 6, § 2707 (2003).
- O.** A covenant not to compete found in an agreement with an independent contractor may not be as restrictive as a covenant found in an agreement with an employee. An employer/employee relationship is more intimate than an independent contractor relationship. Thus, “[t]he legitimate economic interests of an employer in restricting the substantially similar activities of an independent contractor will be more limited than they would be with respect to an employee.” *EDIX Media Group, Inc. v. Mahani*, No. Civ. A. 2186, 2006 WL 3742595, at \*8 (Del. Ch. Dec. 12, 2006).

## DISTRICT OF COLUMBIA

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## DISTRICT OF COLUMBIA

### **I. SUMMARY OF THE LAW**

The Federal Circuit has addressed the issue of covenants not to compete in the context of licensing agreements. See *Litton System Inc. v. Honeywell Inc.*, 87 F.3d 1559 (Fed. Cir. 1996), Judgment vacated in 520 US 1111 (1997).

The Court of Claims has also addressed the issue peripherally in tax cases involving the sale of a business on the requisites of an enforceable covenant restricting competition. See *Forward Communications v. United States*, 608 F.2d 485 (Ct. Cl. 1979); *Richard S Miller & Sons, Inc. v. United States*, 537 F.2d 446 (Ct. Cl. 1976).

### **II. PARAMETERS OF THE “REASONABLENESS” TEST**

#### **A. Ancillary to an employment contract.**

1. There are no reported cases from the Federal Circuit on element of the “reasonableness” test.

#### **B. Incidental to the sale of a business.**

1. Licensing agreements: *In Universal Gym Equip. v. ERWA Exercise Equip.*, 827 F.2d 1542 (Fed. Cir. 1987), the court upheld an agreement by the licensee not to copy the licensed products after the contract had expired. The agreement, which did not set any geographic or time limitations on the covenant, prohibited the licensee from duplicating any of the features and designs produced by the licensing company.

## FLORIDA

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## FLORIDA

### I. STATUTORY CRITERIA FOR NON-COMPETE AGREEMENTS

The applicable Florida Statute governing the enforceability of covenants not-to-compete depends on the date of the covenant's execution. *Bradley v. Health Coalition, Inc.*, 687 So.2d 329, 331 (Fla. 3d Dist. Ct. App. 1997) (“[E]nforceability of a covenant not-to-compete under the Florida Statutes is governed by the law in effect at the time the agreement was entered into”). To determine enforceability, non-compete covenants must be divided into three classes: (1) covenants executed on or after July 1, 1996, (2) covenants executed between June 28, 1990 and July 1, 1996, and (3) covenants executed before June 28, 1990.<sup>1</sup> *American Residential Servs., Inc. v. Event Technical Servs., Inc.*, 715 So.2d 1048, 1049 (Fla. 3d Dist. Ct. App. 1998).

#### Restrictive Covenants Executed On or After July 1, 1996

Section 542.335 of the Florida Antitrust Act governs the enforceability of covenants not-to-compete entered into on or after July 1, 1996. FLA. STAT. § 542.335 (2004). Such a covenant is enforceable if: (i) it is in writing signed by the party against whom enforcement is sought, and (ii) it contains reasonable limitations as to time, geographic area, and line of business. *Id.* at § 542.335(1). There are two additional requirements under the statute: (1) the existence of one or more legitimate business interests that justify the restriction, *Id.* at § 542.335(1)(b), and (2) the scope of activity restrained must not impose a greater restraint than reasonably necessary to protect the legitimate business interests of the promisee. *Id.* at § 542.335(1)(c).

#### Restrictive Covenants Executed Between June 28, 1990 and July 1, 1996

Section 542.33 of the Florida Antitrust Act, as amended by Chapter 90-216, Section 1, Laws of Florida, governs the enforceability of covenants not-to-compete entered into on or after June 28, 1990 but before July 1, 1996. FLA. STAT. § 542.33 (1990); FLA. STAT. § 542.331 (2004). This statute provides that a non-compete covenant prohibiting a similar business and/or the solicitation of existing customers is enforceable if: (i) it contains reasonable limitations as to time and geographic area, (ii) the promisee continues to carry on a similar business, and (iii) the covenant itself is reasonable in general. FLA. STAT. § 542.33(2)(a) (1990). The promisee must also prove that irreparable injury will result if the covenant is not enforced. *Id.; Gupton v. Village Key & Saw Shop, Inc.*, 656 So.2d 475, 478 (Fla. 1995). Irreparable injury is presumed to exist when trade secrets, customer lists, or direct solicitation of existing customers are involved. FLA. STAT. § 542.33(2)(a) (1990). The standard for enforceability

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<sup>1</sup> For purposes of this discussion, the law under the most recent statute will be primarily discussed.

under this section is more stringent than the standard under Section 542.335. American Residential Servs., 715 So.2d at 1049.

#### Restrictive Covenants Executed Before June 28, 1990

A non-compete covenant executed prior to June 28, 1990 is enforceable if (i) it contains reasonable limitations as to time and geographic area, and (ii) the promisee continues to carry on a similar business. FLA. STAT. § 542.33(2)(a) (1985). Proof of irreparable injury is not required, but is instead presumed upon breach of the covenant, regardless of the specific type of interest involved. *Gupton*, 656 So.2d at 477-78. The statute applies only to restraints on carrying on a similar business and on the solicitation of existing customers. FLA. STAT. § 542.33(2)(a) (1985).

## **II. LEADING CASE LAW**

The purpose behind Florida's statute governing covenants not-to-compete is to provide protection of identifiable assets of a business while still allowing competing businesses to hire experienced workers and employees to secure better-paying employment. See *University of Florida, Bd. of Trustees v. Sanal*, 837 So.2d 512, 516 (Fla. 1 st Dist. Ct. App. 2003). As a result, a plaintiff seeking to enforce a covenant not-to-compete must demonstrate that the defendant's breach of the covenant harms one or more of the plaintiff's legitimate business interests by way of actual or threatened misappropriation of identifiable assets of the business. *Id.*

## **III. ELEMENTS OF ENFORCEABILITY**

### **A. Agreements Arising in an Employment Context**

To enforce a non-compete agreement, the employer has the burden of establishing (i) the existence of one or more legitimate business interests that justify the restriction, FLA. STAT. § 542.335(1)(b), and (ii) the specific restriction is reasonably necessary to protect these interests. *Id.* at § 542.335(1)(c). The specific limits placed on the employee by the restraint must be reasonable as to geographic territory, duration, and scope of activities in light of the employer's line of business and protectable interests. Establishment of these elements shifts the burden to the employee to prove that the restriction is overbroad, overlong, or otherwise not reasonably necessary. *Id.* If the employee shows the restraint is too broad, the restraint is not void. Instead, the court must modify the scope of the restraint and enforce it as modified. *Id.* Covenants that are not supported by a legitimate business interest, however, are unenforceable. *Id.* at § 542.335(1)(b).

Florida courts also consider whether an enforceable agreement between

the parties that is supported by consideration exists, and whether the agreement has been materially breached by the employer. *Bradley*, 687 So.2d at 333; *North American Prods., Corp. v. Moore*, 196 F.Supp.2d 1217, 1224 (M.D. Fla. 2002). A material breach, such as an employer's failure to pay an ex-employee compensation owed under the employment agreement, renders the non-compete covenant unenforceable against the employee. *Moore*, 196 F.Supp.2d at 1224. An employer's modification of the terms of an employment at will relationship does not amount to a material breach of the employment agreement and therefore does not void a non-compete covenant. *Kupscznk v. Blasters, Inc.*, 647 So.2d 888, 891 (Fla. 2d Dist. Ct. App. 1994)

1. **Protectable Interests:** The most recent statute adopted by the Florida Legislature provides a non-exhaustive list of protectable interests such as (1) trade secrets,<sup>2</sup> (2) other valuable confidential business information, (3) substantial relationships with specific prospective or existing customers, (4) goodwill associated with a business by way of a trademark,<sup>3</sup> or a specific geographic location or trade area, and (5) extraordinary or specialized training. FLA. STAT. § 542.335(1)(b).

To prove a legitimate interest based on trade secrets, the information involved must meet Florida's statutory definition of trade secrets. FLA. STAT. § 542.335(1)(b)(1). However, otherwise confidential information that does not comport with the definition of trade secrets under FLA. STAT. § 688.002(4) also establishes a legitimate business interest. *Id.* at § 542.335(1)(b)(2); *American Residential Servs.*, 715 So.2d at 1049. Simply asserting that trade secrets or confidential information is involved is not enough to support the non-compete agreement. The employer must provide some evidence that (1) specific trade secrets or confidential information is involved and (2) the employee has knowledge of the trade secrets or confidential information. *See Anich Indus., Inc. v. Raney*, 751 So.2d 767, 770-71 (Fla. 5th Dist. Ct. App. 2000).

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<sup>2</sup> This is expressly limited to Florida's statutory definition of trade secrets which is:  
information, including a formula, pattern, compilation, program, device, method, technique, or process that:

- (a) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and
- (b) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Fla. Stat. § 688.002(4).

<sup>3</sup> This includes trade names, trademarks, service marks, and trade dress.

A legitimate interest based on substantial relationships with specific customers is established where the employee “gains substantial knowledge of [the] employer’s customers, their purchasing history, and their needs and specifications.” *Moore*, 196 F.Supp.2d at 1228. In addition, the employer must identify specific customers in order to establish it has a legitimate business interest. *Sanal*, 837 So.2d at 516 (substantial relationship must be “with a particular, identifiable, individual”).

An employer may establish a legitimate interest based on extraordinary training when the employer invests substantial time and money to provide the employee with skills that the employee did not otherwise possess prior to the employment relationship. *Aero Kool Corp. v. Oosthuizen*, 736 So.2d 25 (Fla. 3d Dist. Ct. App. 1999) (legitimate business interest based on provision of 195 hours of specialized aviation repair training); *Balasco v. Gulf Auto Holding, Inc.*, 707 So.2d 858, 860 (Fla. 2d Dist. Ct. App. 1998) (legitimate business interest based on provision of six month sales training program); *Cf. Austin v. Mid State Fire Equip. of Cent. Fla.*, 727 So.2d 1097, 1098 (Fla. 5th Dist. Ct. App. 1999) (substantial industry experience prior to employment does not create business interest in form of extraordinary or specialized training). The degree of training required to qualify as a legitimate business interest varies based on the specific industry involved in each case, but the training must convey skills that could not be acquired by simply reading a manual. *Hapney v. Central Garage, Inc.*, 579 So.2d 127, 131, 132 (Fla. 2d Dist. Ct. App. 1991), disapproved on other grounds by *Gupton*, 656 So.2d 475. To qualify as extraordinary, the training must exceed that which is usual, regular, common, or customary in the industry. *Dyer v. Pioneer Concepts, Inc.*, 667 So.2d 961, 964 (Fla. 2d Dist. Ct. App. 1996).

The protectable interests discussed above are also recognized by case law interpreting the 1990 amendments, which apply to restrictive covenants executed between June 28, 1990 and July 1, 1996. See *Hapney*, 579 So.2d at 131 (employer's legitimate interest is threshold condition to validity of non-compete covenant and include trade secrets, confidential business lists, customer goodwill, and extraordinary training), disapproved on other grounds by *Gupton*, 656 So.2d 475. As to non-compete covenants entered into prior to June 28, 1990, an employer is not required to show the existence of a legitimate business interest because irreparable injury is presumed to flow from an employee's breach. See *Gupton*, 656 So.2d at 477-78.

2. **Geographic Territory Restrictions:** Relevant factors courts consider in assessing the reasonableness of the covenant's geographic scope include: (i) the area in which the employer does business; (ii) the nature and scope of the employer's business; (iii) the physical location of the employer's customer/clients; and (iv) the location/area in which the employee worked and performed services for the employer. See *e.g., Xerographics, Inc. v. Thomas*, 537 So.2d 140, 143 (Fla. 2d Dist. Ct. App. 1988) (reasonable

restriction of five county territory assigned to defendant during his employment). Courts have generally held reasonable geographic restrictions that cover the territory or area in which the employee worked and performed services for the employer. See *id.*

3. **Time Limitations:** For covenants executed on or after July 1, 1996, the statute provides rebuttable presumptions of reasonable and unreasonable time restrictions. FLA. STAT. § 542.335(1)(d). If the employer's legitimate business interests do not include trade secrets, restraints of six months or less are presumed reasonable in time, while restraints greater than two years in duration are presumed unreasonable. *Id.* If trade secrets are involved, a restraint is presumed reasonable if it spans five years or less, and is presumed unreasonable only if it is for a term greater than ten years. *Id.* at § 542.335(1)(e). When the duration of a restraint is presumptively unreasonable, the employer must provide evidence to support the entire duration of the restraint or else the court will limit the restraint to a period of two years (ten years if trade secrets are involved). *Balasco*, 707 So.2d at 860; *Flickinger v. R.J. Fitzgerald & Co., Inc.*, 732 So.2d 33, 34-5 (Fla. 2d Dist. Ct. App. 1999).

For covenants executed prior to July 1, 1996, courts will determine the reasonableness of the temporal restriction by balancing the employer's interests in preventing competition against the oppressive effect of the restraint on the employee. *Carnahan v. Alexander Proudfoot Co.*, 581 So.2d 184, 185 (Fla. 4th Dist. Ct. App. 1991). In balancing these interests, courts will consider several factors including: (i) the length of the time the employee worked for the employer; (ii) the exact nature of the employee's duties and responsibilities; (iii) the extent of the employee's contact and relationship with customers; and (iv) the applicable business cycle. See *Dominy v. Frank B. Hall & Co.*, 464 So.2d 154, 158 (Fla. 5th Dist. Ct. App. 1985); *Mathieu v. Old Town Flower Shops, Inc.*, 585 So.2d 1160 (Fla. 4th Dist. Ct. App. 1991) (considering employee's position in corporate hierarchy). Courts must also consider the public interest. *Carnahan*, 581 So.2d at 185.

4. **Scope of Activity Restrained:** Generally, a prohibition against engaging in a competing business should be limited to not only the type of business in which the company is engaged but also the specific type of business in which the employee worked. This comports with the requirement that the restraint be reasonably

necessary to justify business interests. FLA. STAT. § 542.335(1)(c); FLA. STAT. 542.33(2)(a) (1990).

Prohibitions against soliciting customers are expressly subject to the requirements of the non-compete statutes. FLA. STAT. §§ 542.33(2)(a); John A. Grant, Jr. and Thomas T. Steele, Restrictive Covenants: Florida Returns to the Original “Unfair Competition” Approach for the 21st Century, 70-Nov Fla. B.J. 53, 54 (1996) (article co-authored by Senate sponsor and principal drafter of Section 542.335, stating that the legislation covers non-competition agreements, non-solicitation agreements, confidentiality agreements, exclusive dealing agreements, and all other contractual restraints of trade). To be enforceable, such a restriction should generally be limited to customers with whom the employee actually worked or had some contact or involvement during employment. See *Moore*, 196 F.Supp.2d at 1228-29. A restriction that applies to all of an employer’s customers may still be enforced, but will be limited by the court to identifiable existing customers. *Sanal*, 837 So.2d 512; *Dyer*, 667 So.2d at 964.

5. **Consideration:** In addition to satisfying the elements of the relevant statute, a non-competition agreement must be supported by adequate consideration. *Wright & Seaton v. Prescott*, 420 So.2d 623, 625-27 (Fla. 4th Dist. Ct. App. 1982), reh’g denied (Fla. 1982). Because non-compete agreements are generally bilateral contracts comprised of mutual executory promises, the doctrine of mutuality of obligation applies. *Id.* at 625. Lack of mutuality at the time the agreement is made will not invalidate a non-compete covenant so long as the employer performs what it promised to do in exchange for the employee’s promise not-to-compete. *Id.* at 627. Thus, adequate consideration for a non-competition agreement exists when the employee signs the agreement at the start of employment if the employer either promises to give written notice of termination or the employer promises to employ and pay the employee for a specific period and subsequently performs that promise. See *id.* An employer’s simple promise to employ and pay the employee is not sufficient consideration when the employment may be terminated at any time without cause. *Id.* The promise of continued employment, however, does serve as adequate consideration supporting a covenant not-to-compete that is entered into after the start of employment, even where the employment is at will. *Open Magnetic Imaging, Inc. v. Nieves-Garcia*, 826 So.2d 415, 417-18 (Fla. 3d Dist. Ct. App. 2002); *Austin*, 727 So.2d at 1098. To ensure enforceability, the agreement should expressly

indicate that it is supported by consideration in the form of continued employment. *Balasco*, 707 So.2d at 860.

6. **Judicial modification:** Under all versions of the statutes and interpretive case law, Florida courts are empowered to reform overbroad covenants to the extent necessary to bring them into compliance with the governing statute. FLA. STAT. § 542.335(1)(c) (requiring court to modify overbroad restraint and grant relief reasonably necessary to protect promisee's interests); *Health Care Fin. Enters., Inc. v. Levy*, 715 So.2d 341, 342 (Fla. 4th Dist. Ct. App. 1998) (under 1990 amendments to section 542.33, courts may modify terms of restrictive covenants to comply with reasonableness requirement of statute); *Flammer v. Patton*, 245 So.2d 854, 859-60 (Fla. 1971) (directing trial court to modify duration of restrictive covenant in pension agreement under pre-1980 version of section 542.33). Because of the availability of judicial modification, some employers take the approach that the covenant should be drafted broadly to have the maximum deterrent effect, and then rely on the court to reform and enforce the covenant to the extent deemed reasonable. This may not be a good idea in light of the fact that the court is authorized by statute to award attorney's fees and costs to the prevailing party in its discretion. FLA. STAT. § 542.335(1)(k).

## B. Agreements Ancillary to the Sale of Business

Generally, covenants not-to-compete that are made in connection with the sale of a business follow the same provisions and guidelines as covenants not-to-compete in the employer/employee context. FLA. STAT. § 542.335. Such covenants made on or after July 1, 1996, are presumed reasonable if they are three years or less in duration and presumed unreasonable if they are more than seven years in duration. *Id.* at § 542.335(1)(d)(3). Nevertheless, covenants not-to-compete must not impose a greater restraint than is reasonably necessary to protect the business conveyed. *Id.* at § 542.335(1)(c).

Similarly, under Section 542.33, the analysis of covenants not-to-compete made in connection with the sale of a business is the same as the analysis for covenants not-to-compete in the employer/employee context. FLA. STAT. § 542.33(2). Courts will generally enforce covenants not-to-compete ancillary to the sale of a business as long as the time restrictions span ten years or less and the scope is reasonable. *See Rinker Materials Co. of West Palm Beach v. Holloway Materials Co.*, 167 So.2d 875 (Fla. 2nd Dist. Ct. App. 1964) (covenant not-to-compete for ten years within 25 miles of plant in concrete products business found reasonable); *Merritt v.*

*Smith*, 446 So.2d 263, 264 (Fla. 2nd Dist. Ct. App. 1984) (covenant not-to-compete ancillary to sale of dry cleaning business in one county for five years enforced); but see *Kaye v. Orkin Exterminating Co.*, 472 F.2d 1213, 1215 (5th Cir.1973) (covenant not-to-compete made in context of sale of business and spanning 20 years held unreasonable where 13 years remained with respect to covenant); *Cerniglia v. C. & D. Farms, Inc.*, 203 So.2d 1 (Fla. 1967) (covenant ancillary to sale of business for twenty-year period and covering the entire United States held void). Covenants made in the context of a partnership dissolution, however, are governed by Section 542.33(3) which states that “[p]artners may, upon or in anticipation of a dissolution of the partnership, agree that all or some of them will not carry on a similar business within a reasonably limited time and area.” FLA. STAT. § 542.33(3).

#### **IV. SUMMARIZATION OF FLORIDA LAW WITH REGARD TO THE USE OF TRADE SECRETS**

Under Florida’s Uniform Trade Secrets Act, employees have a statutory duty not to use or disclose trade secrets received from a current or former employer. FLA. STAT. §§ 688.001 et seq. Even without an enforceable contractual restriction, a former employee is prohibited from misappropriating an ex-employer’s trade secrets. *Id.* at § 688.003. In other words, the employee cannot acquire, disclose, and/or use the information to the detriment of his former employer. See *Del Monte Fresh Produce Co. v. Dole Food Co., Inc.*, 148 F.Supp.2d 1326, 1335 (S.D. Fla. 2001). The employee’s actual use of the information is not required because even the threat of misappropriation is prohibited under the statute. FLA. STAT. § 688.003(1); *Thomas v. Alloy Fasteners, Inc.*, 664 So.2d 59, 60 (Fla. 5th Dist. Ct. App. 1995). Both damages and injunctive relief are recognized as proper remedies to protect trade secrets. FLA. STAT. §§ 688.003, 688.004. Claims brought under Florida’s Uniform Trade Secrets Act are distinct from claims for breach of a covenant not-to compete. FLA. STAT. § 688.008(2)(a).

## GEORGIA

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## GEORGIA

### I. STATUTORY CRITERIA FOR NON-COMPETE AGREEMENTS

The Georgia Constitution states that all contracts that have the effect of or are intended to defeat or lessen competition or encourage a monopoly are illegal and void. GA CONST. ART. 3, §6, PAR. 5

O.C.G.A. § 13-8-2 provides that contracts deemed contrary to public policy will not be enforced. Pursuant to § 13-8-2, contracts in general restraint of trade are contrary to public policy while contracts in partial restraint of trade are not.

In 1990, the Georgia Assembly enacted the Restrictive Covenant Act in an attempt to codify Georgia law on non-compete covenants. O.C.G.A. § 13-8-2.1. The Georgia Supreme Court declared the Act unconstitutional. *Jackson & Coker, Inc. v. Hart*, 405 S.E.2d 253 (1991). Pre-statutory cases remain good law. *Vortex Protective Serv., Inc. v. Dempsey*, 218 Ga. App. 763, 463 S.E.2d 67, 68 (1995).

### II. LEADING CASE LAW

Georgia courts have interpreted O.C.G.A. § 13-8-2 to mean that a non-compete covenant contained in an employment agreement is in partial restraint of trade and not per se void or against public policy. *W.R. Grace & Co. v. Mouyal*, 262 Ga. 464, 465, 422 S.E.2d 529, 531 (1992). A covenant will therefore be upheld if the restraint imposed is reasonable, “is founded on valuable consideration, is reasonably necessary to protect the interest of the party in whose favor it is imposed, and does not unduly prejudice the interests of the public.” *Id.* (citation omitted). “Whether the restraint imposed by the employment contract is reasonable is a question of law for determination by the court, which considers ‘the nature of extent of the trade or business, the situation of the parties, and all the other circumstances’”. *Id.* (citations omitted). “A three-element test of duration, territorial coverage, and scope of activity has evolved as ‘a helpful tool’ in examining the reasonableness of the particular factual setting to which it is applied.” *Id.* (citations omitted).

It is worth noting that, compared to other states, it is extremely difficult to enforce a non-compete covenant in Georgia. *Watson v. Waffle House, Inc.*, 253 Ga. 671, 672-673, 324 S.E.2d 175, 177-178 (1985).

### III. ELEMENTS OF ENFORCEABILITY

#### A. Agreements Arising in an Employment Context

To determine whether a non-compete covenant ancillary to an

employment agreement is reasonable, Georgia courts use a three-pronged test of duration, territorial coverage, and scope of activity. *W.R. Grace*, 262 Ga. at 465, 422 S.E.2d at 531; *Watson*, 253 Ga. at 672, 324 S.E.2d at 177. In determining whether a covenant is reasonably limited with regard to these factors, the court must balance the interest the employer seeks to protect against the impact the covenant will have on the employee, factoring in the effect of the covenant on the public's interest in promoting competition and the freedom of individuals to contract. *Beckman v. Cox Broadcasting Corp.*, 250 Ga. 127, 130, 296 S.E.2d 566, 568 (1982). Further, in determining reasonableness, consideration must be given to the employee's right to earn a living, and the employee's ability to determine with certainty the area within which his post-employment actions are restricted. *W.R. Grace*, 262 Ga. at 466, 422 S.E.2d at 531-532. At the same time, the employer has a protectable interest in the customer relationships its former employee established and/or nurtured while employed by the employer, and is entitled to protect itself from the risk that a former employee might appropriate customers by taking unfair advantage of the contacts developed while working for the employer. *Id.*

Whether a restricted covenant is reasonable is a question of law to be determined by the court. *Osta v. Moran*, 208 Ga. App.544, 546, 430 S.E.2d 837, 839 (1993). The court may make this determination from the language or wording of the covenant itself. *Id.*; *Ken's Stereo-Video Junction, Inc., v. Plotner*, 253 Ga. App. 811, 813-814, 560 S.E.2d 708, 710 (2002). The party seeking to enforce the covenant has the burden of proving reasonableness. *Howard Schultz & Assocs. v. Broniec*, 239 Ga. 181, 184, 236 S.E.2d 265, 268 (1977).

1. **Time Limitations:** There are no time restrictions that are per se unreasonable. *Johnson v. Lee*, 243 Ga. 864, 865 257 S.E.2d 273, 275 (1979). One and two year durations are generally found to be reasonable. *Habif, Arogeti & Wynne, P.C. v. Baggett*, 231 Ga. App. 289, 292, 498 S.E.2d 346, 351 (1998); *Sysco Food Services of Atlanta, Inc. v. Chupp*, 225 Ga. App. 584, 586, 484 S.E.2d 323, 326 (1997). A five-year limitation, however, has also been upheld. *Smith v. HBT, Inc.*, 213 Ga. App. 560, 563, 445 S.E.2d 315 (1994). Limitations in time should bear some relation to the amount of time needed by the former employer to re-establish and solidify its relationships with its customers. *Orkin Exterminating Co. v. Walker*, 251 Ga. 536, 538, 307 S.E.2d 914, 916-917 (1983).
2. **Geographic Territory Restrictions:** Courts will accept as prima facie valid a covenant related to the territory where the employee

was employed as a legitimate protection of the employer's investment in customer relations and good will. *Reardigan v. Shaw Industries, Inc.*, 238 Ga. App. 142, 144, 518 S.E.2d 144, 147 (1999); *Howard Schultz & Assocs. v. Broniec*, 239 Ga. 181, 183-184, 236 S.E.2d 265, 268 (1977). However, a court will not accept as prima facie valid a covenant related to the territory where the employer does business where the only justification is that the employer wants to avoid competition by the employee in that area. *Howard Schultz*, 239 Ga. at 184, 236 S.E.2d at 268.

A territorial restriction that cannot be determined until the date of the employee's termination is too indefinite to be enforced. *New Atlanta Ear, Nose & Throat Associates, P.C. v. Pratt*, 253 Ga. App. 681, 685, 560 S.E.2d 268, 272 (2002) (citation omitted); *AGA, LLC v. Rubin*, 243 Ga. App. 772, 774, 533 S.E.2d 804, 806 (2000). The employee must be able to forecast with certainty the territorial extent of the duty owing to the employer. *New Atlanta*, 253 Ga. App at 685, 560 S.E.2d at 272; *AGA*, 243 Ga. App. at 774, 533 S.E.2d at 806.

There are no territorial restrictions that are per se unreasonable. *Johnson v. Lee*, 243 Ga. 864, 865, 257 S.E.2d 273, 275 (1979). The reasonableness of the territory depends not so much on the geography and size of the territory as on the reasonableness of the territorial restrictions in view of the facts and circumstances surrounding the case. *Rollins Protective Services Co. v. Palermo*, 249 Ga. 138, 139, 287 S.E.2d 546, 548 (1982). Territorial restrictions that encompass the entire United States or the world have been consistently struck down as over broad and unreasonable. *Firearms Training v. System Sharp*, 213 Ga. App. 566, 567-68, 445 S.E.2d 538, 539-40 (1994); *American Software USA, Inc., vs. Moore*, 264 Ga. 480, 483, 448 S.E.2d 206, 209 (1994). Similarly a territory defined as "Metro Atlanta" is considered too vague. *Hamrick v. Kelley*, 260 Ga. 307, 392 S.E.2d 518 (1990). Where a city, as opposed to a metropolitan area, is designated as the center of a radius, the covenant will be upheld. *Keeley v. Cardiovascular Surgical Assoc., P.C.*, 236 Ga. App. 26, 29-30, 510 S.E.2d 880, 884 (1999).

3. **Scope of Activity Restrained:** A covenant must explain with particularity the business activities that the employee is prohibited from performing. *Howard Schultz*, 239 Ga. at 184, 236 S. E. 2d at 268. Further, there should be some rational relationship between these activities and the activities the employee conducted for his

former employer. *Edwards v. Howe Richardson Scale Co.*, 237 Ga. 818, 819-820 229 S.E.2d 651, 652 (1976); *Moore v. Preferred Research, Inc.*, 191 Ga. App. 26, 27, 381 S.E.2d 72, 74 (1989). A covenant wherein the employee is prohibited from accepting employment with a competitor “in any capacity” is likely to be struck down as overly broad. *Howard Schultz*, 239 Ga. at 185, 236 S.E.2d at 268. On the other hand, a covenant that specifies the type of activities it intends to restrict will likely be upheld. *Moore*, 191 Ga. App. at 27-28, 381 S.E.2d at 74.

Covenants not-to-compete and covenants not to solicit are analyzed differently. Covenants not-to-compete prohibit the employee from performing competitive activities in a certain geographic area for a limited time after termination of employment and are designed primarily to protect the employer’s investment of time and money in developing the employee’s skills. *Habif, Arogeti & Wynne, P.C. v. Baggett*, 231 Ga. App. 289, 295, 498 S.E.2d 346, 353 (1998). Non-solicitation covenants, on the other hand, restrict the employee from soliciting business from the employer’s customers or prospective customers after termination of employment and are designed primarily to protect the employer’s investment of time and money in developing customer relationships. *Id.* This type of covenant only requires a territorial restriction if the forbidden clients include the clients with whom the employee did not have a relationship prior to departure. *Id.*

4. **Protectable Interests:** The Georgia Supreme Court has defined protectable interests to be “property, confidential information and relationships, good will and economic advantage.” *Durham v. Stand-By Labor of Georgia*, 230 Ga. 558, 561, 198 S.E.2d 145, 148 (1973). Avoidance of competition is clearly not a protectable interest. *Brunswick Floors* 234 Ga. App. at 300, 506 S.E.2d at 673; *Osta v. Moran*, 208 Ga. App. 544, 547, 430 S.E.2d 837 (1993).

With respect to relationships and good will, an employer has a protectable interest in the customer relationships its former employee established at work and a right to protect itself from the risk that the former employee might use contacts so cultivated to unfairly appropriate customers. *Ken’s Stereo*, 253 Ga. App. at 812-813, 560 S.E.2d at 710; *Darugar v. Hodges*, 221 Ga. App. 227, 229, 471 S.E.2d 33, 35-36 (1996).

An employer’s time and monetary investment in its employee’s skills and development of his craft has also consistently been held to constitute protectable interests. *Beckman v. Cox Broadcasting*

*Corp.*, 250 Ga. 127, 130, 296 S.E.2d 566, 569 (1982); *Brunswick Floors, Inc. v. Guest*, 234 Ga. App. 298, 300, 506 S.E.2d 670, 673 (1998).

Additionally, an employer's confidential information and trade secrets are protectable interests. *Sunstates Refrigerated Services, Inc., v. Griffin*, 215 Ga. App. 61, 63, 449 S.E.2d 858, 860 (1994).

5. **Consideration:** The prospect for employment or continued employment is sufficient consideration for restrictive covenants. *Mouldings, Inc. v. Potter*, 315 F. Supp. 704, 713 (M.D. Ga. 1970); *Thomas v. Coastal Indus. Servs.*, 214 Ga. 832, 108 S.E.2d 328 (1959).
6. **Judicial modification:** Georgia courts have traditionally divided restrictive covenants into two categories: covenants ancillary to an employment contract, which receive strict scrutiny and are not blue-penciled, and covenants ancillary to a sale of business which receive much less scrutiny and may be blue-penciled. *Advance Tech. Consultants v. RoadTrac, LLC*, 250 Ga. App. 317, 319, 551 S.E.2d 735, 736 (2001). Georgia law is clear that if one non-compete or non-solicit covenant in a employment agreement is unenforceable, all such covenants are unenforceable and courts cannot employ the blue pencil doctrine of severability. *Advance Tech. Consultants, LLC*, 250 Ga. App. at 320, 551 S.E.2d at 737; *American Gen. Life & Accident Ins. Co. v. Fisher*, 208 Ga. App. 282, 284, 430 S.E.2d 166, 168 (1993). Moreover, a court will not sever an overbroad covenant not-to-compete and leave intact and enforce a narrower valid covenant not-to-compete also contained in the contract regardless of whether or not there is a severability clause in the contract. *Ceramic & Metal Coatings Corp. v. Hizer*, 242 Ga. App. 391, 394, 529 S.E.2d 160, 163 (2000); *Harville v. Gunter*, 230 Ga. App. 198, 200, 495 S.E.2d 862, 864 (1998); *Sunstates Refrigerated Services, Inc., v. Griffin*, 215 Ga. App. 61, 63, 449 S.E.2d 858, 860 (1994).

## **B. Agreements Ancillary to the Sale of Business**

As discussed above, Georgia courts distinguish between covenants ancillary to employment and covenants ancillary to the sale of a business. *Advance Tech. Consultant*, 250 Ga. App. at 319, 551 S.E.2d at 736. Georgia courts will give greater latitude to covenants ancillary to the sale of a business because of the perceived equality of bargaining power between the parties and because the covenant is a significant part of the consideration for the purchase of the business. *Hicks v. Doors by Mike*,

*Inc.*, 260 Ga. App. 407, 409, 579 S.E.2d 833, 835 (2003); *Hudgins v. Amerimax Fabricated Prods., Inc.*, 250 Ga. App. 283, 285, 551 S.E.2d 393, 396 (2001).

Because of the liberal standard for covenants ancillary to the sale of a business, the attendant benefits of this standard (i.e., blue-penciling and the fact that such a covenant does not need to be in writing), and because non-compete covenants are often executed in connection with the sale of a business, it is frequently litigated in Georgia courts whether a covenant not-to-compete is ancillary to the sale of a business or ancillary to employment. *White v. Fletcher Mayo Assoc.*, 251 Ga. 203, 206-207, 303 S.E.2d. 746, 749-750 (1983). Factors which will be considered in determining whether a covenant is ancillary to the sale of the business include: (i) whether the original company was reliant upon the employee's skills; (ii) whether the employee was represented by an attorney in the transaction; (iii) whether the employment agreement was executed contemporaneously with other documents related to the sale of the business or whether the various documents reference each other; (iv) whether the employee was aware of the consequences of the sale of the stock; (v) whether the employee initiated the negotiations for the sale of the business or whether there was any pressure or duress; (vi) whether the employee profited from the sale; and (vii) whether the employee received relief from any personal liability for the debts of the pre-merger company. *Drumheller v. Drumheller Bag & Supply, Inc.*, 204 Ga. App. 623, 626-627, 420 S. E. 2d 331, 334-335 (1992). Further, if a contract for sale of a business and an employment contract are part of the same transaction, they may be construed together to supply missing elements and blue-penciled to make overbroad terms valid. *Lyle v. Memar*, 259 Ga. 209, 378 S.E.2d 465 (1989).

#### **IV. SUMMARIZATION OF GEORGIA LAW WITH REGARD TO THE USE OF CONFIDENTIAL INFORMATION**

Georgia's Trade Secrets Act of 1990, O.C.G.A. §§ 10-1-760 et seq., supersedes other civil remedies for misappropriation of a trade secret. § 10-1-767(a). The Act defines a "trade secret" as information-- including technical or nontechnical data, financial plans, or customer lists-- that derives economic value from not being known or readily ascertainable to others, and that "is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." § 10-1-761(4); *Bacon v. Volvo Service Center*, 2004 WL 396461 (Ga. Ct. App. March 4, 2004). Thus, to establish a cause of action for misappropriation, an employer must show the information at issue has value and that the employer took measures for secrecy. *Stone v. Williams General Corp.*, 2004 WL 415296 (Ga. Ct. App. March 8, 2004) (finding there was sufficient evidence to support the

jury's verdict that former employees had misappropriated the employer's trade secrets where it was shown that employer went above and beyond its restrictive covenant to protect its customer documentation by restricting access to documents and instructing employees not to leave building with documents).

Trade secrets need not be in the form of written data to warrant protection, see *Avnet, Inc. v. Wyle Labs., Inc.*, 263 Ga. 615, 619, 437 S.E.2d 302 (1993), but Georgia law generally does not prevent a departing employee from using the skills and information he acquired at work. "A person who leaves the employment of another has a right to take with him all the skill he has acquired, all the knowledge he has obtained, all the information that he has received, so long as nothing is taken that is the property of the employer." *Vendo Co. v. Long*, 213 Ga. 774, 778, 102 S.E.2d 173 (1958).

## HAWAII

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## HAWAII

### **I. Statement of the Law:**

Hawaii law generally permits post-employment covenants not to compete provided that the restrictions are “reasonable.”

Hawaii’s unfair competition statute, Haw. Rev. Stat. § 480-4, provides:

(c) . . . [I]t shall be lawful for a person to enter into any of the following restrictive covenants or agreements ancillary to a legitimate purpose not violative of this chapter, unless the effect thereof may be substantially to lessen competition or to tend to create a monopoly in any line of commerce in any section of the State:

1. A covenant or agreement by the transferor of a business not to compete within a reasonable area and within a reasonable period of time in connection with the sale of the business;
2. A covenant or agreement between partners not to compete with the partnership within a reasonable area and for a reasonable period of time upon the withdrawal of a partner from the partnership;

\* \* \*

3. A covenant or agreement by an employee or agent not to use the trade secrets of the employer or principal in competition with the employee's or agent's employer or principal, during the term of the agency or thereafter, or after the termination of employment, within such time as may be reasonably necessary for the protection of the employer or principal, without imposing undue hardship on the employee or agent.

In *Technicolor, Inc. v. Traeger*, 57 Haw. 113, 551 P.2d 163 (1976), the Hawaii Supreme Court interpreted this statute as not prohibiting a general post-employment termination covenant not to compete, and adopted a “rule of reason test.” “Under this test, a covenant is valid only if the court deems it to be ‘reasonable.’” *Id.* at 122 (citation omitted).

### **II. PARAMETERS OF THE “REASONABLENESS” TEST**

#### **A. Ancillary to an employment contract:**

Generally, an employment covenant not to compete will be deemed “not reasonable,” and therefore invalid, if:

- i. “it is greater than required for the protection of the person for whose benefit it is imposed;
- ii. it imposes undue hardship on the person restricted; or
- iii. its benefit to the covenantee is outweighed by injury to the public.”

*Technicolor*, 57 Haw. at 122 (citation omitted).

In applying this test, a court must examine such factors as geographical scope, length of time, and breadth of the restriction placed on a given activity. *Id.*

#### **B. Ancillary to the sale of a business**

Haw. Rev. Stat. § 480-4(c)(1) permits an agreement by the transferor of a business not to compete within a reasonable area and within a reasonable period of time in connection with the sale of the business.

### **III. GENERAL COMMENTS:**

- A. Protectable interests:** Customer contacts and customer lists, specialized training, confidential information (e.g., pricing information), and trade secrets all constitute employer interests protectable under Hawaii law by a reasonable covenant not to compete. *See Technicolor, supra; UARCO, Inc. v. Lam*, 18 F. Supp. 2d 1116 (D. Haw. 1998); *The 7’s Enters., Inc. v. Del Rosario*, 111 Haw. 484, 143 P. 3d 23 (2006).
- B. Scope of the restriction:** Courts have approved a three-year, state-wide covenant not to compete and a three-year covenant not to compete in the City and County of Honolulu. *See Technicolor, supra; The 7’s, supra.* A court has also enforced a two-year “customer contact” restriction. *See UARCO, supra.*
- C. Blue pencil/modification:** Hawaii courts have not specifically addressed the issue of whether a court may modify an overly broad covenant not to compete to make it enforceable.
- D. Consideration:** The Hawaii Supreme Court has suggested that employment may be sufficient consideration to support a reasonable non-compete restriction. *See Technicolor*, 57 Haw. at 120.
- E. Choice of law:** Although no Hawaii case has specifically addressed choice of law issues in the context of a covenant not to compete case, Hawaii courts generally follow a contractual choice of law provision provided the chosen state has some nexus to the parties or the contract.

See, e.g., *Airgo, Inc. v. Horizon Cargo Transp., Inc.*, 66 Haw. 590, 595, 670 P.2d 1277 (1983). In the absence of a choice of law provision, Hawaii courts will generally apply the law of the state with the most significant relationship to the parties and the subject matter of the dispute. See, e.g., *Roxas v. Marcos*, 89 Haw. 91, 117 n. 16 (1998) (not a covenant not to compete case).

- F. Trade secret definition:** Haw. Rev. Stat. § 482B-2.
- G. Protection of confidential or trade secret information (absent a covenant not to compete)?** Yes. Hawaii's Uniform Trade Secrets Act, Haw. Rev. Stat. §§ 482B-1 *et seq.* prohibits actual or threatened misappropriation of trade secrets.
- H. Case examples of covenants not to compete upheld by the courts:**

*Technicolor, Inc. v. Traeger*, 57 Haw. 113, 551 P.2d 163 (1976): The Hawaii Supreme Court upheld the enforcement of a 3 year statewide non-compete restriction against the former General Manager of the plaintiff's photofinishing business.

*UARCO, Inc. v. Lam*, 18 F. Supp. 2d 1116 (D. Haw. 1998): The United States District Court for the District of Hawaii enjoined two former sales employees of the plaintiff, for a period of two years, from contacting any of the plaintiff's customers which the employees solicited, contacted or dealt with during the former employees' employment with the plaintiff.

*The 7's Enters., Inc. v. Del Rosario*, 111 Haw. 484, 143 P. 3d 23 (2006): The Hawaii Supreme Court upheld an injunction against a former "briefer" of the plaintiff which prohibited her from working as a briefer for a period of three years within the City and County of Honolulu. The Court determined that an employer's proprietary, extensive and confidential training which provides skills beyond those of a general nature is a legitimate interest which may be considered in weighing the reasonableness of a non-competition covenant.

## IDAHO

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## IDAHO

### I. STATEMENT OF THE LAW

Covenants not to compete are enforceable in Idaho if they are reasonable. *Intermountain Eye and Laser Centers, P.L.L.C. v. Miller*, 142 Idaho 218, 127 P.3d 121 (2005). There is no Idaho statute that specifically addresses the enforceability of covenants not to compete.

### II. PARAMETERS OF THE “REASONABLENESS” TEST

Covenants not to compete in an employment contract, though enforceable, are disfavored and will be strictly construed against the employer. *Freiburger v. J-U-B Eng’rs, Inc.*, 141 Idaho 415, 419, 111 P. 3d 100, 104 (2005). A covenant not to compete contained in an employment contract must be reasonable as applied to the employer, the employee, and the public. *Id.* at 420. Moreover, a covenant not to compete is reasonable only if the covenant: (1) is not greater than is necessary to protect the employer in some legitimate business interest; (2) is not unduly harsh and oppressive to the employee; and (3) is not injurious to the public. *Id.* All restrictions, including those of time, area, scope and money, must be reasonable. *Intermountain, supra.*

### III. GENERAL COMMENTS

**A. Protectable interests:** Customer contacts, trade secrets and other confidential information are interests protectable by a covenant not to compete. *Intermountain, supra.*

**B. Scope of the restriction:** A court found reasonable a 1-year covenant in any country in which the former employer conducts business. *WGI Heavy Minerals, Inc. v. Gorrill*, 2006 WL 637030 (Idaho Dist. Ct. 2006). Another court found reasonable a 1-year covenant against competing “in the truck brokerage business” within a 300-mile radius of Boise. *Magic Valley Truck Brokers, Inc. v. Meyer*, 133 Idaho 110, 115, 982 P. 2d 945, 950 (Ct. App. 1999). 2-year and 3-year, 25 mile radius non-compete covenants against physicians were held to be reasonable. *Dick v. Geist*, 107 Idaho 931, 693 P. 2d 113 (Ct. App. 1985); *Marshall v. Covington*, 81 Idaho 199, 339 P. 2d 504 (1959).

A 2-year covenant barring an engineer (independent contractor) from offering, selling, or trading his services to past or current customers of the former company, was held to be overly broad and unenforceable. *Pinnacle Performance, Inc. v. Hessing*, 135 Idaho 364, 17 P. 3d 308, 313 (Ct. App. 2001). See also *Freiburger v. J-U-B Eng’rs, Inc.*, 141 Idaho 415,

423, 111 P. 3d 100, 108 (2005) (2 year customer restriction overly broad and unenforceable, in part because restriction was not limited to customers with whom employee had worked); *Insurance Ctr. v. Taylor*, 94 Idaho 896, 499 P.2d 1252 (1972) (covenant unlimited as to time, area and scope of activity was overly broad and unenforceable).

- C. **Blue pencil/modification:** Idaho courts will “blue pencil” a non-compete agreement as to “an unreasonable word or two,” but they will not add clauses to a contract to make it reasonable. *Freiburger*, 141 Idaho at 423, 111 P. 3d at 108. In addition, the covenant must not be so lacking in its essential terms relating to area, time and subject matter limitations that the court itself would have to supply these essential terms in order to make the covenant reasonable. *Id.*; *Pinnacle Performance, supra*.
- D. **Consideration:** Continued at-will employment is valid consideration for a post-hire non-compete restriction. *Insurance Assocs. Corp. v. Hansen*, 111 Idaho 206, 207-208, 723 P. 2d 190, 191-192 (Ct. App. 1986) (employee agreed to non-compete restriction a year and a half after beginning employment). Presumably a covenant not to compete executed at the inception of employment would also be supported by valid consideration, although no reported Idaho court decision has specifically addressed this issue.
- E. **Choice of law:** Idaho courts generally recognize contractual choice of law provisions, unless the chosen state has no substantial relationship to the contract or the parties or the application of the provision would contravene a fundamental public policy of a state with a materially greater interest than the chosen state. *See Great Plains Equip., Inc. v. Northwest Pipeline Corp.*, 132 Idaho 754, 765 n. 3, 979 P. 2d 627, 638 n. 3 (1999); *Ward v. PureGro Co.*, 128 Idaho 366, 368-369, 913 P. 2d 582, 584-585 (1996) (citing to Restatement (Second) of Conflicts of Laws). In the absence of a choice of law provision, Idaho courts generally apply the law of the state with the “most significant relationship” to the contract and the parties. *See, e.g., Seubert Excavators, Inc. v. Anderson Logging Co.*, 126 Idaho 648, 651-52, 889 P. 2d 82, 85-86 (1995).<sup>4</sup>
- F. Trade secret definition: Idaho Code § 48-801(5).
- G. **Protection of confidential or trade secret information (absent a covenant not to compete)?** Yes. Idaho’s Trade Secrets Act, Idaho

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<sup>4</sup> None of these decisions involved covenants not to compete and we are not aware of any reported decisions involving a choice of law analysis for non-compete restrictions.

Code § 48-801 *et seq.* prohibits actual or threatened misappropriation of trade secrets.

## ILLINOIS

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## ILLINOIS

### I. JUDICIAL STATEMENT OF THE LAW

#### A. Contracts ancillary to an employment relationship:

A restrictive covenant may be held enforceable only if the time and territorial limitations are reasonable and the restrictions are reasonably necessary to protect a legitimate business interest of the employer . . . .

There are two general situations in which an employer's legitimate business interests may be found for purposes of enforcing a covenant not to compete: (1) where, by the nature of the business, [the employer] has a near-permanent relationship with its customers and but for his employment, [the former employee] would not have had contact with them; or (2) where the former employee learned trade secrets or acquired other confidential information through his employment [with the former employer] and subsequently tried to use it for his own benefit.

Factors to be considered in determining whether a near-permanent relationship exists between an employer and its customers . . . include the time, cost, and difficulty involved in developing and maintaining the clientele, the parties' intention to remain affiliated for an indefinite period, and the continuity as well as the duration of the relationship.

*Label Printers v. Pflug*, 206 Ill. App. 3d 483, 564 N.E.2d 1382, 1387, *appeal denied*, 575 N.E.2d 916 (2d Dist. 1991) (reversing entry of preliminary injunction because no near-permanent customer relationship existed). *See also, Lawrence & Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 226 Ill. Dec. 331, 685 N.E.2d 434 (2d Dist. 1997); *Reinhardt Printing Co. v. Feld*, 142 Ill. App. 3d 9, 490 N.E.2d 1302 (1st Dist. 1986); *Shapiro v. Regent Printing Co.*, 192 Ill. App. 3d 1005, 549 N.E.2d 793 (1st Dist. 1989).

#### B. Contracts ancillary to the sale of a business:

Illinois courts require the restrictive covenant to be (1) necessary in its full extent for the protection of the buyer; (2) unoppressive to the seller; and (3) not harmful to the public . . . . Aside from justifying the durational and territorial extent of the restraint . . . plaintiff's first task is to illustrate injury to its legitimate business interest apart from defendant's violation of the

agreement.

The protectable interest which a buyer procures through a restrictive covenant ancillary to a sale of assets originates either in the good will of the business sold or the confidential information used in its operation . . . . The explanation for this rationale is that a restrictive covenant must safeguard one or both of the aforementioned interests; otherwise, the injury caused to the public as well as the promisor in restraining competition and restricting services necessarily outweighs any benefit to the promisee.

The good will of a business has been defined to be the benefit which arises from it having been carried on for some time in a particular place, or by a particular person or from the use of a particular trade-mark, and its value consists in the probability that the customers of the old firm will continue to be customers of the new.

*Marathon Petroleum Co. v. Chronister Oil Co.*, 687 F. Supp. 437, 439-40 (C.D. Ill. 1988) (denying application for preliminary injunction because covenant not to compete was found to be illegal restraint of trade without protecting good will or trade secrets). *See also, Boyar-Schultz Corp. v. Tomasek*, 94 Ill. App. 3d 320, 323, 418 N.E.2d 911, 913 (1st. Dist. 1981).

In general, it is easier to enforce a restrictive covenant in the context of the sale of a business than it is in the employment context, as “a covenant ancillary to the sale of a business need only be reasonable in duration, geographical area, and scope to be enforceable.” *Loewen Group Int’l, Inc. v. Haberichter*, 912 F. Supp. 388, 392 (N.D. Ill. 1996) (finding that covenant was ancillary to an employment agreement rather than the sale of a business). The determination of whether a covenant is in the context of a sale of business or employment turns on the intent of the parties to protect the integrity of the sale, and such facts may include whether (1) whether the covenant was a condition precedent to the sale; (2) whether the covenant was incorporated into the sale agreement; and (3) the time that the parties entered into the covenant in relation to the time that the parties executed the sales agreement. *Id.* at 393. *See also Howard Johnson & Co. v. Feinstein*, 241 Ill. App. 3d 828, 609 N.E.2d 930 (1st Dist. 1993) (holding that noncompetition agreements were ancillary to the sale of a business where the client base was the primary asset and the agreements were entered into to protect the buyer against losing those clients); *Business Records Corp. v. Lueth*, 981 F.2d 957, 959 (7th Cir. 1992) (a covenant not to compete executed by a key employee as part of the sale of a business, for which the employee received an option to purchase stock in the new corporation, was a covenant ancillary to the sale of a business).

## II. PARAMETERS OF THE "REASONABLENESS" TEST

### A. Ancillary to an employment relationship:

"A restrictive covenant's reasonableness is measured by its hardship to the employee, its effect upon the general public, and the reasonableness of the time, territory and activity restrictions." *Lawrence & Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 226 Ill. Dec. 331, 338, 685 N.E.2d 434, 441 (2d Dist. 1997).

In determining whether a geographic restriction is reasonable, Illinois courts generally look to whether the restricted area is "coextensive with the area in which the employer is doing business." *Lawrence & Allen*, 226 Ill. Dec. at 339, 685 N.E.2d at 442 (citing *Arpac Corp. v. Murray*, 226 Ill. App. 3d 65, 77, 589 N.E.2d 640 (1st. Dist. 1992)).

Illinois courts will allow a customer restriction to substitute for, or complement, a geographic restriction. *Abbott-Interfact Corp. v. Harkabus*, 250 Ill. App. 3d 13, 619 N.E.2d 1337 (2d Dist. 1993). However, those restrictions must be reasonably related to the employer's interest in protecting customer relations that its employees developed while working for the employer. *Lawrence & Allen*, 226 Ill. Dec. at 338, 685 N.E.2d at 441.

In assessing the reasonableness of the time restrictions in restrictive covenants, Illinois courts will look to such factors as the time it takes to acquire and maintain clients, the nature of the industry, and the average length of the customers' relationship with the employer. See *Arpac Corp. v. Murray, supra*.

A number of decisions have enforced restrictive covenants when their restrictions were found to be reasonable under the particular circumstances of the case. See, e.g., *Midwest Tel., Inc. v. Oloffson*, 298 Ill. App. 3d 548, 699 N.E.2d 230 (3d Dist. 1998) (finding one-year, 100-mile-radius restriction reasonable); *Tyler Enters. of Elwood v. Shafer*, 214 Ill. App. 3d 145, 573 N.E.2d 863 (3d Dist. 1991) (enforcing covenant not to compete for three years within a 50 mile radius of employer's place of business); *Business Records Corp v. Lueth*, 981 F.2d 957, 961 (7th Cir. 1992) (enforcing covenant not to compete in Illinois for two years after termination); *World Wide Pharmacal Distributing Co. v. Kolkev*, 5 Ill. App.2d 201, 125 N.E.2d 309 (1st Dist. 1955) (enforcing covenant not to compete for one year within United States); *Agrimerica, Inc. v. Mathes*, 170 Ill. App.3d 1025, 524 N.E.2d 947 (1st Dist. 1988) (enforcing covenant not to compete for two years in three state area); *Gorman Publishing Co.*

*v. Stillman*, 516 F. Supp. 98 (N.D. Ill. 1980) (enforcing covenant not to compete for two years in United States).

However, when those restrictions are not reasonable, the courts will not enforce the restrictive covenant. See, e.g., *Liautaud v. Liautaud*, 221 F.3d 981 (7th Cir. 2000) (refusing to enforce covenant which lacked time restriction); *Lawrence & Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 226 Ill. Dec. 331, 685 N.E.2d 434 (2d Dist. 1997) (two-year restriction encompassing entire United States was unreasonable in geographic scope); *Johnson v. Country Life Ins. Co.*, 12 Ill. App. 3d 158, 300 N.E.2d 11 (4th Dist. 1973) (restriction in 11-state area was unreasonable); *George S. May Int'l Co. v. Int'l Profit Associates*, 256 Ill. App. 3d 779, 628 N.E.2d 647 (1st Dist. 1993) (geographic restriction covering 36 states plus two Canadian provinces was overly broad and unenforceable because it included areas where company had never conducted business); *Lee/O'Keefe Ins. Agency v. Ferega*, 163 Ill. App. 3d 997, 516 N.E.2d 1313 (4th Dist. 1997) (restrictive covenant prohibiting employee from competing for five years within 100-mile radius of Springfield, Illinois was both temporally and geographically unreasonable).

#### **B. Ancillary to the sale of a business:**

When the covenant is in the sale-of-business context, a less stringent standard of reasonableness is applied. See, e.g., *Decker, Berta & Co. v. Berta*, 225 Ill. App. 3d 24, 587 N.E.2d 72 (4th Dist. 1992) (finding 3-year, 35-mile-radius noncompete covenant reasonable); *Russell v. Jim Russell Supply, Inc.*, 200 Ill. App.3d 855, 558 N.E.2d 115, 122-23 (5th Dist. 1990) (enforcing covenant not to compete for 10 years within 100 miles of former partner's trucking partnership); *but see Boyar-Schultz Corp. v. Tomasek*, 94 Ill. App. 3d 320, 418 N.E.2d 911, 914 (1st Dist. 1981) (covenant prohibiting competition throughout United States and Canada for five years held unreasonable and unenforceable).

### **III. GENERAL COMMENTS**

#### **A. Protectable interests:**

Protectable interests include trade secrets and the protection of "near-permanent" business relationships. *Label Printers v. Pflug*, 206 Ill. App.3d 483, 564 N.E.2d 1382, 1387, *appeal denied*, 575 N.E.2d 916 (2d Dist. 1991).

Factors to consider in determining whether a "near-permanent" relationship exists include: (1) the number of years the employer required to develop the clientele; (2) the amount of money the employer invested in

developing the clientele; (3) the degree of difficulty in developing the clientele; (4) the amount of personal customer contact with the clientele by the employee; (5) the extent of the employer's knowledge of its clientele; (6) the length of time the customers have been associated with the employer; and (7) the continuity of the employer-customer relationship. *Agrimerica, Inc. v. Mathes*, 199 Ill. App. 3d 435, 557 N.E. 2d 357 (1st Dist. 1990); *Millard Maintenance Serv. Co. v. Bernero*, 207 Ill. App. 3d 736, 566 N.E.2d 379, 386 (1st Dist. 1990); *A.B. Dick Co. v. American Pro-Tech*, 159 Ill. App. 3d 786, 793, 514 N.E.2d 45, 49 (1st Dist. 1987).

Although these *Agrimerica* factors have been cited by a number of cases, at least one court has held that these seven factors, though helpful in some cases, need not be applied in all cases. In *Springfield Rare Coin Galleries, Inc. v. Mileham*, 250 Ill. App. 3d 922, 935, 620 N.E.2d 479 (4th Dist. 1993), the court declined to utilize the near-permanent relationship factors outlined in *Agrimerica* and stated that those factors did not need to be applied when a given business falls squarely within the professional services (where near-permanent relationships are inherent) or the sales categories (where near-permanent relationships with customers are generally absent).

#### **B. Severability/Modification of Overly Broad Restrictions:**

If a covenant is overbroad it may be modified by the court to make it enforceable. See *House of Vision v. Hiyane*, 37 Ill.2d 32, 225 N.E.2d 21, 25 (1967) (a court may modify a covenant; however, the court should take into account the fairness of the restraint initially imposed by the employer). See also *Gillespie v. Carbondale & Marion Eye Ctrs., Ltd.*, 251 Ill. App. 3d 625, 622 N.E.2d 1267 (5th Dist. 1993) (recognizing that Illinois courts have long had the authority to limit overly broad restrictive covenants to make them enforceable); *Business Records Corp v. Lueth*, 981 F.2d 957, 961 (7th Cir. 1992) (covenant prohibiting competition in any business that provides the same services as the former employer provided was revised to prohibit competition in any business that provided the same services as the former employee provided for his employer); *Ntron Int'l Sales Co., Inc. v. Carroll*, 714 F. Supp. 335, 337 (N.D. Ill. 1989) (covenant containing no geographic limitations was not per se unenforceable).

Many Illinois courts have refused to modify covenants which they determined to be unreasonable or ambiguous. See, e.g., *Lawrence & Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 226 Ill. Dec. 331, 340, 685 N.E.2d 434, 443 (2d Dist. 1997) (declining to modify overly broad restrictive covenants); *North Am. Paper Co. v. Unterberger*, 172 Ill. App. 3d 410, 526 N.E.2d 621 (1st Dist. 1988) (refusing to reform agreement "redolent of the historical past when involuntary servitude was an

accepted practice"); *Prudential Ins. Co. of Am. v. Sempetrean*, 171 Ill. App. 3d 810, 525 N.E.2d 1016, 1020 (1st Dist. 1988) (agreement without limitations as to time or geographic territory too vague and ambiguous to be enforced); *Dryvit Sys. v. Rushing*, 132 Ill. App. 3d 9, 477 N.E.2d 35, 39 (1st Dist. 1985) (affirming decision not to modify agreement which was unreasonable in time and geographic scope).

In some instances, Employers have successfully enforced covenants which could be construed to be overbroad by seeking only partial enforcement of those covenants. See, e.g., *Cockerill v. Wilson*, 51 Ill.2d 179, 281 N.E.2d 648 (1972) (enforcing 20-mile geographical limitation when covenant provided for 30-mile geographical limitation).

Illinois courts are more likely to modify overly broad restrictions in a noncompetition agreement when the agreement itself provides that it terms can be modified or severed. See *Abbott-Interfast Corp. v. Harkabus*, 250 Ill. App. 3d 13, 619 N.E.2d 1337 (2d Dist. 1993) (citing *McRand, Inc. v. Van Beelen*, 138 Ill. App. 3d 1045, 486 N.E.2d 1306 (1st Dist. 1985)).

### **C. Continued Employment as Consideration:**

Continued employment is sufficient consideration to support a covenant not to compete as long as the employment continues for a "substantial period." *Lawrence & Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 226 Ill. Dec. 331, 338, 685 N.E.2d 434, 441 (2d Dist. 1997); *Applied Micro, Inc. v. SJI Fulfillment, Inc.*, 941 F.Supp. 750, 753 (N.D. Ill. 1996); *Curtis 1000, Inc. v. Suess*, 24 F.3d 941, 945-47 (7th Cir. 1994) (8 years' subsequent employment was a "substantial period"); *Millard Maintenance Serv. Co. v. Bernero*, 207 Ill. App. 3d 736, 566 N.E.2d 379, 383 (1st Dist. 1990) (covenant supported by over three years of continued employment after covenant was executed); *Shapiro v. Regent Printing Co.*, 192 Ill. App. 3d 1005, 549 N.E.2d 793, 795 (1st Dist. 1989); *Corroon & Black of Ill. v. Magner*, 145 Ill. App.3d 151, 494 N.E.2d 785, 791 (1st Dist. 1986); *McRand v. Van Beelen*, 138 Ill. App. 3d 1045, 486 N.E.2d 1306, 1314 (1st Dist. 1985) (covenants not to compete enforced because employees had remained employed for "substantial period" of two years after execution of the covenants); *but see Mid-Town Petroleum, Inc. v. Gowen*, 243 Ill. App. 3d 63, 70, 611 N.E.2d 1221 (1st Dist. 1993) (seven months' employment after execution of noncompete did not provide the requisite consideration; court reasoned that "while a peppercorn can be considered sufficient consideration to support a contract in court of law, a peppercorn may be insufficient consideration in a court of equity to support . . . a preliminary injunction").

- D.** A forfeiture of benefits provision is treated as a restraint of trade and thus is subject to the same analysis as other noncompetition covenants. See *Briggs v. R.R. Donnelley & Sons Co.*, 589 F.2d 39, 41 (1st Cir. 1978) (applying Illinois law) (forfeiture provision enforced after considering temporal duration and geographic extent of commitment in covenant not to compete). See also, Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.*, concerning federal limitations on forfeiture of post-employment benefits.
- E.** The covenant not to compete is enforceable if the employee is discharged unless the termination is the result of the employer's bad faith. *Rao v. Rao*, 718 F.2d 219, 224 (7th Cir. 1983).
- F.** Ordinarily, attorneys' are awarded to the prevailing party if and only if the written agreement so provides. In *Prairie Eye Center, Ltd. v. Butler*, 329 Ill. App. 3d 293, 768 N.E.2d 414 (4th Dist. 2002), the court granted the employer attorneys' fees exceeding \$164,000 that it incurred in seeking relief for a former employee's repeated violation of a noncompetition agreement. The court found that the agreement at issue provided for the payment of attorneys' fees, and awarded such fees pursuant to the contractual agreement. However, in *Child v. Lincoln Enterprises, Inc.*, 51 Ill. App. 2d 76, 200 N.E.2d 751, 754 (4th Dist. 1964), the court did not award fees because there was no contractual provision concerning fees, holding that fees "are ordinarily not allowable either as costs or damages . . . unless . . . permitted by statute or by virtue of contractual stipulation."
- G.** A material breach of an employment contract may excuse performance of a covenant not to compete contained in that contract. *Galesburg Clinic Ass'n v. West*, 302 Ill. App. 3d 1016, 1018, 706 N.E.2d 1035, 1036-37 (3d Dist. 1999); *C.G. Caster Co. v. Regan*, 88 Ill. App. 3d 280, 410 N.E.2d 422, 426 (1st Dist. 1980); *Wyatt v. Dishing*, 127 Ill. App. 3d 716, 469 N.E.2d 608, 611 (5th Dist. 1984); *Sahadi v. Continental Ill. Nat. Bank and Trust Co.*, 706 F.2d 193, 196 (7th Cir. 1983). The test for materiality is whether the breach "is of such a nature and of such importance that, if anticipated in advance, the contract would not have been entered into." *Galesburg Clinic*, 302 Ill. App. 3d at 1018, 706 N.E.2d at 1037.
- H.** Although there remains a split within the Illinois appellate courts, most courts that have addressed the issue have found that a covenant need not be ancillary to an employment *agreement*, but rather that an at-will employment *relationship* is all that is needed to satisfy the ancillarity requirement. See *Applied Micro, Inc. v. SJI Fulfillment, Inc.*, 941 F.Supp. 750, 754 (N.D. Ill. 1996) (finding that employment relationship is all that is necessary to meet ancillarity requirement); *Abel v. Fox*, 274 Ill. App. 3d 811, 654 N.E. 2d 591 (4th Dist. 1995) (same); *Lawrence & Allen, Inc. v.*

*Cambridge Human Resource Group, Inc.*, 226 Ill. Dec. 331, 685 N.E.2d 434 (2d Dist. 1997) (adopting holding of *Abel*); *but see Creative Entertainment, Inc. v. Lorenz*, 265 Ill. App. 3d 343, 638 N.E. 2d 217 (1st Dist. 1994) (finding that written contract was required to show ancillarity).

- I. The law of the state chosen by the parties will be applied unless the chosen state has no substantial relationship to the parties or the transaction or if the law to be applied is “repugnant to a strong and fundamental policy of Illinois.” *Labor Ready, Inc. v. Williams Staffing, LLC*, 149 F. Supp. 2d 398, 405 (N.D. Ill. 2001) (choice of Washington law enforced); *American Food Mgmt., Inc. v. Henson*, 105 Ill. App.3d 141, 434 N.E.2d 59, 62 (5th Dist. 1982) (choice of Missouri law enforced).
- J. Illinois has enacted the Illinois Trade Secret Act, 765 ILCS 1065/1, *et seq.* The Act incorporates large portions of the Uniform Trade Secret Act.
- K. 11. Customer lists or customer information are trade secrets only if the lists or information have been developed by the employer over a number of years at great expense and kept under tight security. *Label Printers v. Pflug*, 206 Ill. App. 3d 483, 564 N.E.2d 1382, 1389 (2d Dist. 1991).
- L. Where there is a covenant not to compete between a vendor and a vendee, the court should employ a “similar” – if not identical – analysis as that used in covenants related to employment agreements, to determine its enforceability. *A.J. Dralle, Inc. v. Air Technologies*, 255 Ill. App. 3d 987, 627 N.E.2d 690 (2d Dist. 1994) (finding that vendee lacked protectable interest in customer list that would permit enforcement of restrictive covenant; vendee failed to show customer relationships were near permanent).
- M. The state's Code of Professional Responsibility imposes restrictions on the enforcement of covenants not to compete within the legal profession. See Rule 5.6 of the Illinois Rules of Professional Conduct, 134 Ill.2d R 5.6. See *also* A.B.A. Sec. Lab. Emp. L. Rep. 207 (Supp. 1996).
- N. Noteworthy articles and/or publications: Sabin, Constructing a Viable Restrictive Covenant in Employment Contracts, 72 Ill. B.J. 310 (1984); Petersen, Gene A., Understanding Illinois Noncompetition Agreements and Restrictive Covenants, 89 Ill. B.J. 472 (Sept. 2001); Kitch, Paul R., Employee Noncompete and Nondisclosure Restrictive Covenants: A Summary of Illinois Law Governing Noncompete Restrictive Covenants, With Suggestions to Employers for Protecting Sensitive Information, 88 Ill. B.J. 230 (April 2000); Weiss, S.A., and McMurry, G.M., Modification of Employment Restrictive Covenants: A Call for Equitable Analysis, 82 Ill. B.J. 256 (May 1994).

## INDIANA

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## INDIANA

### I. JUDICIAL STATEMENT OF THE LAW

#### A. Contracts ancillary to an employment contract:

All such covenants as this are in restraint of trade and are not favored by the law. They will be enforced only if they are reasonable with respect to the covenantee, the covenantor and the public interest. We make this determination upon the basis of the facts and circumstances surrounding each case. It depends upon a consideration of the legitimate interests of the covenantee . . . and the protection granted by the covenant, in terms of time, space and the types of conduct or activity prohibited.

*Licocci v. Cardinal Assoc., Inc.*, 445 N.E.2d 556, 560 (Ind. 1983).

The covenant will be enforced if it is reasonable, is ancillary to the main purpose of a lawful contract, and is necessary to protect the covenantee in the enjoyment of the legitimate benefits of the contract or to protect the covenantee from the dangers of unjust use of those benefits by the covenantor.

*Ohio Valley Communications, Inc. v. Greenwell, Inc.*, 555 N.E.2d 525, 528 (Ind. Ct. App. 4th Dist. 1990).

#### B. Contracts ancillary to the sale of a business

Covenants not to compete in employment contracts are in restraint of trade and not favored by the law . . . They are strictly construed against the covenantee. . . On the other hand, covenants involved in the sale of a business are not as ill-favored at law as are employee covenants. . .

In the former situation (sale of a business) there is more likely to be equal bargaining power between the parties; the proceeds of the sale generally enable the seller to support himself temporarily without the immediate practical need to enter into competition with his former business; and a seller is usually paid a premium for agreeing not to compete with the buyer. Where the sale of the business includes good will, as this sale did, a broad noncompetition agreement may be necessary to assure that the buyer receives that which he purchased. . . On the other hand, an ordinary employee typically has only his own labor or skills to sell and often is not in a position to bargain with his employer. Postemployment restraints in such cases must be scrutinized carefully to see that they go no further than necessary to protect an employer's legitimate interests, such as trade secrets or confidential customer information. . .

Employer-employee covenants not to compete are reviewed with stricter scrutiny than covenants not to compete ancillary to the sale of a business . . . because of the value of the goodwill purchased.

Of primary importance is the question of whether the covenant not to compete is reasonable as to the covenantee . . . and whether it is reasonable as to time, space and the activity restricted.

*Fogle v. Shah*, 539 N.E.2d 500, 502-03 (Ind. Ct. App. 4th Dist. 1989) (citations omitted).

## II. PARAMETERS OF THE "REASONABLENESS" TEST

### A. Ancillary to an employment contract:

To determine whether a covenant is "reasonable," Indiana courts generally consider three factors: (1) whether the restraint is reasonably necessary to protect the employer's business; (2) the effect of the restraint on the employee, and (3) the effect of enforcement upon the public interest. In determining the reasonableness, factors to be considered are the scope of the legitimate business interests of the employer and the geographic and temporal limits on the restraint. *Norlund v. Faust*, 675 N.E.2d 1142, 1154 (Ind. Ct. App. 1997).

In order to show reasonableness, the employer must demonstrate that "the former employee has gained a unique competitive advantage or ability to harm the employer before such employer is entitled to the protection of a noncompetition covenant." *Hahn v. Drees, Perugini & Co.*, 580 N.E.2d 457, 459 (Ind. Ct. App. 2d Dist. 1991).

"A covenant not to compete is unreasonable when it is broader than necessary for the protection of a legitimate business interest in the terms of the geographic area, time period, and activities restricted." *Smart Corp. v. Grider*, 650 N.E.2d 80, 83 (Ind. Ct. App. 1995).

Absent special circumstances, the geographic restriction should be no broader than the employee's, rather than the employer's, geographic area of work. See, e.g., *Commercial Bankers Life Ins. Co. v. Smith*, 515 N.E.2d 110 (Ind. Ct. App. 1987) (covenant restricting employee from competing within entire state of Indiana was unreasonably broad when former employee worked primarily in just the northern part of the state).

In looking at temporal restrictions, Indiana courts have generally found that restrictive covenants with terms of one to three years after the termination of employment are reasonable. See, e.g., *McGlothen v. Heritage Envtl. Servs., LLC*, 705 N.E. 2d 1069, 1071 (Ind. Ct. App. 1999) (1 year enforceable); *Liccoci v. Cardinal Assoc., Inc.*, 445 N.E. 2d 556 (Ind. 1983) (1 year enforceable); *4408, Inc. v. Losure*, 373 N.E.2d 889 (Ind. Ct. App. 1978 (3 years enforceable). Occasionally, Indiana courts have enforced restrictions of five years after employment ends. See, e.g., *Rollins v. American State Bank*, 487 N.E.2d 842, 843 (Ind. Ct. App. 1986); *Miller v. Frankfort Bottle Gas*, 202 N.E.2d 395 (Ind. Ct. App. 1964).

A number of decisions in Indiana have enforced restrictive covenants when the restrictions were found to be reasonable in both geographic and temporal limitations. See, e.g., *Medical Specialists, Inc. v. Sleweon*, 652 N.E.2d 517, 522-28 (Ind. Ct. App. 1995) (2-year, 10-mile-radius-of-10-hospitals covenant not to compete enforceable); *Fumo v. Medical Group of Michigan City*, 590 N.E.2d 1103, 1109 (Ind. Ct. App. 3d Dist. 1992) (2-year, 25-mile-radius covenant enforced against physician); *Raymundo v. Hammond Clinic Ass'n*, 449 N.E.2d 276, 278 (Ind. Ct. App. 1983) (upholding covenant for two years and 25 miles on physician); *4408, Inc. v. Losure*, 373 N.E.2d 889 (Ind. Ct. App. 1978) (3 years covenant prohibiting coffee service salesman from competing in his former area enforceable); *Liccoci v. Cardinal Assoc., Inc.*, 445 N.E. 2d 556 (Ind. 1983) (enforcing 1-year restriction on salesmen selling same products to former customers in same territory, and 60 days on anyone within former territory and former employer's customers anywhere); *Field v. Alexander & Alexander, Inc.*, 503-N.E.2d 627, 632 (Ind. Ct. App. 1987) (upholding two-year limitation on soliciting customers of employer at time of termination if employee had personal contact with that customer in the preceding two years); *Welcome Wagon v. Haschert*, 127 N.E.2d 103, 105 (Ind. Ct. App. 1955) (upholding five-year restriction upon former employee of welcoming service where employee was a civic leader in that city).

A restriction defined by clients may substitute for geographic limitation. See, e.g., *JAK Prods., Inc. v. Wiza*, 986 F.2d 1080, 1090 (7th Cir. 1993) (applying Indiana law and upholding 1-year restriction on fundraiser for police organizations contacting entities with ongoing business relationship with employer on date of termination). However, in the absence of a geographical limitation, the covenant must list a specific limited class of persons with whom contact is prohibited. See, e.g., *Commercial Bankers Life Ins. Co. of Am. v. Smith*, 516 N.E.2d 110 (Ind. Ct. App. 1987).

When the restrictions contained in the restrictive covenant are not reasonable, Indiana courts will not enforce the covenant. See, e.g., *Cap Gemini Am. v. Judd*, 597 N.E.2d 1272, 1288 (Ind. Ct. App. 1st Dist. 1992) (set of 1-year noncompetition agreements covering three states was unenforceable because the geographic area in the covenant was broader than the area where the employees worked); *Burk v. Heritage Food Serv. Equip., Inc.*, 737 N.E.2d 803, 811-12 (Ind. Ct. App. 2000) (2-year covenant which barred employee from working "in any capacity" for a competitor was overly broad); *Harvest Ins. Agency, Inc. v. Inter-Ocean Ins. Co.*, 492 N.E.2d 686, 689-90 (Ind. 1986) (covenant between insurer and agent unenforceable where it contained no time limitation, as restriction on not replacing "existing coverage" is of unascertainable duration); *Donahue v. Permacel Tape Corp.*, 127 N.E.2d 235, 236 (Ind.1955) (3-year restriction in United States and Canada on salesman unreasonable and invalid); *Hahn v. Drees. Perugini & Co.*, 581 N.E.2d 457, 461 (Ind. Ct. App. 1991) (covenant restraining doing business with former employer's past customers overbroad); *College Life Ins. Co. v. Austin*, 466 N.E.2d 738, 744 (Ind. Ct. App. 1984) (covenant void where it contains no limitations as to time or geography); *Slisz v. Munzenreider Corp.*, 411 N.E.2d 700, 702 (Ind. Ct. App. 1980) (covenant with store manager of retail furniture store

unenforceable where it prohibited involvement in any "similar" business in any city where former employer operated a store); *Frederick v. Professional Bldg. Maintenance Indus., Inc.*, 344 N.E.2d 299, 300-01 (Ind. Ct. App. 1976) (covenant preventing former employee from furnishing janitorial services for 10 years in 8-county area unreasonable where geographic area broader than area in which former employee had worked and pricing information did not have long-term value).

#### **B. Ancillary to the sale of a business:**

When the covenant is in the sale-of-business context, a less stringent standard is applied. See *Fogle v. Shah*, 539 N.E.2d 500, 502 (Ind. Ct. App. 4th Dist. 1989) (enforcing three-year, twelve-state restriction on former owner/operators of pension consulting firm and restriction with no-time limit on doing business with clients at time of sale); *McCart v. H & R Block, Inc.*, 470 N.E.2d 756, 763 (Ind. Ct. App. 1984) (enforcing former franchisee's covenant not to compete with franchisor in tax return business within 50 miles).

However, even when the covenant is in a sale-of-business context, the courts require that the restraints be reasonable under the circumstances, or else the covenant will be found unenforceable. See, e.g., *Young v. Van Zandt*, 449 N.E.2d 300, 305 (Ind. Ct. App. 1983) (covenant binding seller for five years within 200 miles of Evansville unenforceable because one part of business only in Evansville); *South Bend Consumers Club, Inc. v. United Consumers Club, Inc.*, 572 F.Supp. 209, 214 (N.D. Ind. 1983) (restrictive covenant in franchise agreement with consumer buying club unenforceable because it lacked any geographic restriction); *Kladis v. Nick's Patio, Inc.*, 735 N.E.2d 1216 (Ind. Ct. App. 2000) (noncompetition agreement unenforceable because prohibitions on activity went beyond the activities of the business sold)

### **III. GENERAL COMMENTS**

#### **A. Protectable interests:**

Indiana courts have recognized the following items to constitute protectable interests: goodwill, contacts with present customers, identity of customers and customer lists (at least in large, diffuse markets), requirements of customers, trade or business secrets, other confidential information not rising to level of a trade secret (such as in-house knowledge), and training. See *In re Uniservices, Inc.*, 517 F.2d 492, 496 (7th Cir. 1975) (requirements of customers); *Harvest Ins. Agency, Inc. v. Inter-Ocean Ins. Co.*, 492 N.E.2d 686, 690 (Ind. 1986) (goodwill through customer contact and renewal of policies already in force); *Licocci v. Cardinal Assocs., Inc.*, 445 N.E.2d 556, 561 (Ind. 1983) (goodwill, trade secrets and confidential information); *Donahue v. Permacel Tape Corp.*, 127 N.E.2d 235, 240 (Ind. 1955) (goodwill, including names, addresses and requirements of customers); *Hahn v. Drees, Perugine & Co.*, 581 N.E.2d 457, 460 (Ind. Ct. App. 2d Dist. 1991) (goodwill); *Rollins v.*

*American State Bank*, 487 N.E.2d 842 (Ind. Ct. App. 1986); *Young v. Van Zandt*, 449 N.E.2d 300, 304 (Ind. Ct. App. 1983) (sale of goodwill); *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208 (Ind. Ct. App. 1982) (customer lists and in-house knowledge); *Jenkins v. King*, 65 N.E.2d 121 (Ind. 1955) (trade secrets and other confidential information).

Generally, an employer has no protectable interest in restricting contact with its past customers or clients. *Hahn v. Drees, Perugine & Co.*, 581 N.E.2d 457, 461 (Ind. Ct. App. 2d Dist. 1991). An employer also has no protectable interest in the general knowledge, information, and skills gained by an employee in the course of his or her employment. *Brunner v. Hand Indus.*, 603 N.E.2d 157 (Ind. Ct. App. 1992).

**B. Severability/Modification of Overly Broad Restrictions:**

If a covenant is overbroad, a court will not enforce it. However, a court may – but is not required to – “blue pencil” the agreement by striking unenforceable language, but only where the reasonable parts are clearly separated from the unreasonable ones. *See Hahn v. Drees, Perugine & Co.*, 581 N.E.2d 457, 461-62. An Indiana court will not add new terms or language to the covenant. *College Life Ins. Co. of Am. v. Austin*, 466 N.E.2d 738 (Ind. Ct. App. 1984); *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 214-15 (Ind. Ct. App. 1982).

If the covenant as written is not reasonable, Indiana courts may not create a reasonable restriction under the guise of interpretation, because to do so “would subject the parties to an agreement they have not made.” *Licocci v. Cardinal Assocs., Inc.*, 445 N.E.2d 556, 561 (Ind. 1983)

However, in *JAK Products, supra*, the Seventh Circuit, under the guise of interpreting the intent of the parties, limited the terms “customer” or “client” to entities with an ongoing business relationship with former employer. 986 F.2d at 1086-89.

**C. Continued Employment as Consideration:**

Continued employment is sufficient consideration for a non-competition agreement. *See, e.g., Ackerman v. Kimball Int'l, Inc.*, 652 N.E.2d 507 (Ind. 1995); *Leatherman v. Management Advisors, Inc.*, 448 N.E.2d 1048, 1050 (Ind. 1983); *Rollins v. American State Bank*, 487 N.E.2d 842 (Ind. Ct. App. 1986).

**D.** A forfeiture of benefits provision is not treated as a restraint of trade and thus is not subject to the same type of analysis. *Schlumberger Technology Corp. v. Blaker*, 859 F.2d 512, 516-17 (7th Cir. 1988) (applying Indiana law).

**E.** A noncompetition agreement may be enforceable if the employee is discharged; however, where the employer discharges the employee in bad

faith, a court may refuse to enforce it. *Gomez v. Chua Medical Corp.*, 510 N.E.2d 191, 195 (Ind. App. 1987).

- F.** Attorney's fees may be recovered under the Uniform Trade Secrets Act for "willful and malicious" misappropriation, Ind. Code. Ann. § 24-2-3-5, or where there exists an independent basis for such recovery, such as damages on an injunction bond, *City of Elkhart v. Smith*, 191 N.E.2d 522, 523-24 (Ind. Ct. App. 1963), or where provided by contract, see *Dahlin v. Amoco Oil Corp.*, 567 N.E.2d 806, 812 (Ind. Ct. App. 1991).
- G.** Where the employer materially breaches the employment contract, the employee is not required to abide by the terms of either a covenant contained in that employment contract or a covenant incorporated by reference from that contract into another agreement. *Sallee v. Mason*, 714 N.E.2d 757, 762-63 (Ind. Ct. App. 1999); *Hendershot v. Indiana Medical Network, Inc.*, 750 N.E.2d 798 (Ind. Ct. App. 2001); cf. *Barnes Group, Inc. v. O'Brien*, 591 F.Supp. 454, 462-63 (N.D. Ind. 1984) (isolated occurrences in which employer's other salesmen called upon customers assigned to employee did not rise to level of breach of contract so as to allow employee to avoid restrictive covenant).
- H.** A choice of law provision in a contract will be followed if the chosen law bears a substantial relationship to the parties or the transaction. *Barrow v. ATCO Mfg. Co.*, 524 N.E.2d 1313, 1315 (Ind. App. 1988); *Austin Powder Co. v. Wallwork*, 761 F. Supp. 612, 616 (S.D. Ind. 1990).

In the absence of a choice of law provision, Indiana courts will use the "most intimate contacts" test to determine which state's law will govern. *OVRs Acquisition Corp. v. Community Health Serv., Inc.*, 657 N.E.2d 117, 124 (Ind. Ct. App. 1995).
- I.** Indiana has enacted the Indiana Uniform Trade Secrets Act, Ind. Code. Ann. § 24-2-3-1, *et. seq.*, which defines trade secrets protected by that Act.
- J.** The state's Code of Professional Responsibility imposes restrictions on the enforcement of covenants not to compete within the legal profession. See Indiana Rules of Prof. Conduct, Rule 5.6. See also A.B.A. Sec. Lab. Emp. L. Rep. 239 (Supp. 1996).
- K.** Noteworthy articles and/or publications: Bowers, Katz & Backs, Covenants Not to Compete: Their Use and Enforcement in Indiana, 31 Val. U. L. Rev. 65 (Fall 1996); F. Joseph Jaskowiak, Covenants Not to Compete in Employment Agreements, 26 Res Gestae 508 (1983).



## IOWA

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## IOWA

### I. OVERVIEW OF THE LAW

#### A. Statutory Statement of the Law

Not applicable.

#### B. Judicial Statement of the Law

1. The general rule in Iowa is that [courts] will enforce a noncompetitive provision in an employment contract if the covenant is reasonably necessary for the protection of the employer's business and is not unreasonably restrictive of the employee's rights nor prejudicial to the public interest . . . . [The] rule is analogous to the Restatement rule which provides that a noncompetitive agreement is unreasonably in restraint of trade if "(a) the restraint is greater than is needed to protect the promisee's legitimate interest or (b) the promisee's need is outweighed by the hardship to promisor and the likely injury to the public." *Iowa Glass Depot, Inc. v. Jindrich*, 338 N.W.2d 376, 381 (Iowa 1983) (citing *RESTATEMENT (SECOND) OF CONTRACTS* § 188(1)). See *Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d 368 (Iowa 1971), *modified*, 190 N.W.2d 413 (Iowa 1971).
2. Covenants not to compete must be tightly limited as to time and area or they are unreasonably restrictive. *Revere Transducers, Inc. v. Deere & Co.*, 595 N.W.2d 751, 761 (Iowa 1999).
3. Factors used to determine whether a covenant not to compete was justified and reasonable are: (a) proximity of employee to employer's customers, (b) nature of business, (c) employee's access to information peculiar to business, (d) nature of occupation restrained, (e) amount and type of training given to employee, and (f) matters of basic fairness. *Iowa Glass*, 338 N.W.2d at 382-84; *Revere Transducers*, 595 N.W.2d at 761.
4. Protectable interests: good will, clients, special employee training, trade secrets, customer contacts, and other confidential business information. See *Dain Bosworth, Inc. v. Brandhorst*, 356 N.W.2d 590, 595 (Iowa App. 1984); *Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d 368, 373 (Iowa 1971), *modified*, 190 N.W.2d 413 (Iowa 1971); *Orkin Exterminating Co. v. Burnett*, 146 N.W.2d 320, 324 (Iowa 1967); *American Express Fin. Advisors v. Yantis*, 358 F. Supp. 2d 818, 829 (N.D. Iowa 2005); *Pro Edge v. Gue*, 374 F. Supp. 2d 711, 741 (N.D. Iowa 2005); *Uncle B's Bakery, Inc. v.*

*O'Rourke*, 920 F. Supp. 1405, 1429 (N.D. Iowa 1996) (trade secrets). See also *PFS Distribution Co. v. Raduechel*, 492 F. Supp. 2d 1061, 1075 (S.D. Iowa 2007) (Common law prevents employee from using confidential information acquired from and peculiar to the employer's business, even in the absence of a non-compete agreement).

5. An unreasonably broad restrictive covenant ancillary to an employment contract is enforceable in equity to the extent it is reasonable. *Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d at 374. See *Moore Bus. Forms, Inc. v. Wilson*, 953 F. Supp. 1056, 1064 (N.D. Iowa 1996); *Phone Connection v. Harbst*, 494 N.W.2d 445, 449 (Iowa App. 1993) (both citing *Ehlers*); But see *Lamp v. American Prosthetics, Inc.*, 379 N.W.2d 909, 910-11 (Iowa 1986)(refusing to rewrite or partially enforce covenant that court viewed as extremely restrictive).

## II. CONSIDERATION ISSUES

### A. Adequate Consideration

1. A covenant not to compete signed at the inception of employment is generally sufficient consideration. *Curtis 1000, Inc. v. Youngblade*, 878 F. Supp. 1224, 1259-60 (N.D. Iowa 1995);
2. Continuing employment for an indefinite period generally is sufficient consideration to support a covenant not to compete. *Moore Bus. Forms, Inc. v. Wilson*, 953 F. Supp. 1056 (N.D. Iowa 1996); *Pro Edge v. Gue*, 374 F. Supp. 2d 711, 741 (N.D. Iowa 2005); *Phone Connection, Inc. v. Harbst*, 494 N.W.2d 445, 449 (Iowa 1992); *Iowa Glass Depot, Inc., supra*, 338 N.W.2d at 381; *Farm Bureau Serv. Co. v. Kohls*, 203 N.W.2d at 209, 212 (Iowa 1972).

### B. Inadequate Consideration

1. Consideration is not present where one covenants to perform an already existing obligation. *Insurance Agents, Inc. v. Abel*, 338 N.W.2d 531, 533-34 (Iowa Ct. App. 1983) (where employer was bound to employ employee for three years, the promise of continued employment one-year into the agreement was not sufficient consideration).

## III. PARAMETERS OF THE GOVERNING STATUTE AND THE "REASONABLENESS" TEST AS APPLICABLE

## A. Non-competes Ancillary to an Employment Agreement

### 1. Held Enforceable

- (a) *Ales v. Anderson, Gabelmann, Lower & Whitlow*, 728 N.W.2d 832 (Iowa 2007) (covenant by former partner of accounting firm not to compete for five years and within 50 miles of former employer held enforceable); *Uncle B's Bakery, Inc. v. O'Rourke*, 920 F. Supp. 1405 (N.D. Iowa 1996) (A five-year, 100-mile radius covenant was upheld where it barred a former plant manager from competing or having any interest in a business or corporation that competes directly or indirectly with the bagel bakery); *Accord Curtis 1000, Inc. v. Youngblade*, 878 F. Supp. 1224, 1262 (N.D. Iowa 1995) (stating that a five-year limitation was at the limit of what an Iowa court will enforce);
- (b) *Orkin Exterminating Co. v. Burnett*, 146 N.W.2d 320 (Iowa 1967) (covenant not to compete for three years with former employer/pest control company within ten miles of any town in which former employee performed services for the company found reasonable);
- (c) *Tasco, Inc. v. Winkel*, 281 N.W.2d 280 (Iowa 1979) (covenant prohibiting allegedly key employee from competing with his employer anywhere within the United States for one year held not unreasonable as a matter of law);
- (d) *White Pigeon Agency, Inc. v. Madden*, 2001 WL 855366 (Iowa App. 2001) (insurance salesperson's covenant not to solicit clients of her former employer for three years after termination of employment and within five county area in which salesperson sold to former employer's customers, upheld);
- (e) *Pro Edge v. Gue*, 374 F. Supp. 2d 711, 741 (N.D. Iowa 2005) (covenant not to compete prevented former employee from competing with his former employer for a period of one year and within 250 miles of one of the former employer's facilities held enforceable).

### 2. Held Unenforceable or Modified

- (a) *Lemmon v. Hendrickson*, 559 N.W.2d 278, 282 (Iowa 1997) (rejecting former employer's attempt to construe a covenant not to compete as prohibiting the solicitation and servicing of its customers indefinitely because it was an impermissible temporal restriction);
- (b) *Lamp v. American Prosthetics, Inc.*, 379 N.W.2d 909, 910 (Iowa 1986) (en banc) (covenant prohibiting competition within 100 miles of any of employer's Iowa offices, which would have the effect of prohibiting competition anywhere in the state, found unreasonably broad);
- (c) *Farm Bureau Serv. Co. v. Kohls*, 203 N.W.2d 209 (Iowa 1972) (covenant prohibiting competition for two years in a two-county area found unreasonably broad as to geographic area; modified and enforced with respect to six townships in which the former employee worked);
- (d) *Phone Connection, Inc. v. Harbst*, 494 N.W.2d 445, 449 (Iowa App. 1992) (A covenant not to compete was judicially modified from a five-year period to a two-year period and the geographic region was modified to cover the area in which the employer had established business);
- (e) *Wachovia Securities, L.L.C. v. Stanton*, 571 F. Supp. 2d 1014 (N.D. Iowa 2008) (refusing to issue a temporary restraining order against former employee where the former employer had established a breach of contract; where the covenant preventing solicitation of former clients had no temporal limit, the employer did not have a substantial likelihood of demonstrating that the agreement was enforceable).

## **B. Non-competes Incidental to the Sale of a Business**

### **1. Held Enforceable**

- (a) *American Express Financial Advisors., Inc. v. Yantis*, 358 F. Supp. 2d 818 (N.D. Iowa 2005) (non-compete covenant in a franchise agreement restricting competition and solicitation for a one-year period in the area the franchisee worked was reasonable to protect business and customer good will);
- (b) *Sausser v. Kearney*, 126 N.W. 322 (Iowa 1910) (covenant not to compete in the same town for two years incidental to sale

of lumber business upheld as reasonable); *Cole v. Edwards*, 61 N.W. 940 (1895) (covenant by a partner/physician not to compete in the same town for the seller's lifetime incidental to the sale of a partnership interest upheld);

2. Held Unenforceable or Modified

- (a) *Rasmussen Heating & Cooling, Inc. v. Idso*, 463 N.W.2d 703, 704 (Iowa Ct. App. 1990) (covenant not to compete for a period of ten years was not tightly time limited or reasonably necessary for the protection of business)
- (b) *Baker v. Starkey*, 144 N.W.2d 889, 895 (Iowa 1966) (in case predating Iowa's acceptance of equitable modification doctrine, covenant providing that partner would not compete against partnership in any town or city in the continental United States in which the partnership was rendering services to clients at the time of termination of the agreement found unreasonable and unenforceable).
- (c) *Kunz v. Bock*, 163 N.W.2d 442 (Iowa 1968) (covenant incidental to sale of business lacking time and geographic limits found unreasonable and unenforceable);

#### IV. GENERAL COMMENTS

##### A. Specific Issues

- 1. Is a covenant not to compete enforceable if the employee is discharged? Not necessarily. Although, "discharge by the employer is a factor opposing the grant of an injunction, to be placed in the scales in reaching the decision whether the employee should be enjoined." *Ma & Pa. Inc. v. Kelly*, 342 N.W.2d 500, 502-03 (Iowa 1984) (denying enforcement of non-competition agreement where the employee was discharged for economic reasons pursuant to contract that gave the employer the right to discharge employee "for any cause whatsoever").
- 2. Will an employer's breach of the employment agreement relieve the employee of his obligation not to compete? Generally, yes. "In Iowa, a breaching party cannot demand performance from the non-breaching party." *Moore Bus. Forms, Inc. v. Wilson*, 953 F. Supp. at 1066 (citing *Orkin Exterminating Co. v. Burnett*, 146 N.W.2d at 324). In the sale-of-business context, where a business seller has materially breached a covenant not to compete with the buyer, the

buyer is justified in suspending payments otherwise due under the sales contract incorporating such covenant. See *Van Oort Constr. Co. v. Nuckoll's Concrete Serv., Inc.*, 599 N.W.2d 684, 691-93 (Iowa 1999), and cases cited therein.

3. Are attorney's fees recoverable? Attorney's fees are recoverable where they are authorized by statute or by an agreement between parties. *Ales v. Anderson, Gabelmann, Lower & Whitlow, P.C.*, 728 N.W.2d 832, 842-43 (Iowa 2007) (arbitrator could not reduce attorney's fees award where the agreement provided that the prevailing party could recover such fees and costs).
4. Will a choice of law provision in the contract be followed? It depends. Iowa courts follow RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 when deciding whether to enforce a contractual choice of law provision. *Curtis 1000, Inc. v. Youngblade*, 878 F. Supp. at 1251. Generally, the law of the chosen state will be applied unless the court determines that the chosen state has "no substantial relationship to the parties or the transaction" and "there is no other reasonable basis for the parties' choice." *Id.* at 1253. In addition, an Iowa court will refuse to enforce a choice of law provision if it finds that application of the chosen state's law would contradict the public policy of a state that has a materially greater interest in the dispute than the chosen state. *Id.* at 1255.

## **B. Miscellaneous**

1. In *Van Hosen v. Bankers Trust Co.*, 200 N.W.2d 504, 509 (Iowa 1972), the court held that a forfeiture provision in a pension plan was "so unreasonable as to be in violation of public policy," and therefore was unenforceable.
2. Trade secrets defined: The Iowa Trade Secrets Act, I.C.A. 550.2, subd. 4, defines trade secret as "information, including but not limited to a formula, pattern, compilation, program, device, method, technique, or process that is both of the following: (a) Derives economic value, actual or potential, from not being readily ascertainable by proper means by a person able to obtain economic value from its disclosure or use. (b) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy or confidentiality." *U.S. West v. Consumer Advocate*, 498 N.W.2d 711 (Iowa 1993).
3. Noteworthy articles and/or publications: Note, *Covenants Not To Compete in the Transfer of a Business - Selected Problems*, 24

DRAKE L. REV. 639 (1975); *Curtis 1000, Inc. v. Youngblade*, 878 F. Supp. 1224 (N.D. Iowa 1995).

4. Iowa courts permit a much greater restraint by covenants incidental to sale or transfer of a business than by covenants ancillary to an employment contract. *Baker v. Starkey*, 144 N.W.2d at 898.

## KANSAS

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## KANSAS

### I. STATUTORY AUTHORITY

Kansas has no statute governing the enforceability or reasonableness of covenants not to compete.

### II. SUMMARY OF LAW

A non-competition clause is valid if it is ancillary to any lawful contract, and if it is reasonable and not adverse to the public welfare. Covenants contained in employment agreements are strictly construed against the employer. If the purpose of the covenant is to avoid ordinary competition, it is unreasonable and unenforceable. In analyzing whether a covenant not to compete is reasonable, Kansas courts analyze the following four factors: (1) Does the covenant protect a legitimate business interest of the employer? (2) Does the covenant create an undue burden on the employee? (3) Is the covenant injurious to the public welfare? (4) Are the time and territorial limitations contained in the covenant reasonable? *Graham v. Cirocco*, 69 P.3d 194, 1998 (Kan. Ct. App. 2003); *Weber v. Tillman*, 913 P.2d 84, 90 (Kan. 1996).

### III. ELEMENTS OF ENFORCEABILITY

#### A. Covenant Must Be Ancillary to a Lawful Contract

Covenants not to compete must be ancillary to a lawful contract. They can be ancillary to an employment contract or incidental to the sale of a business. See *Graham v. Cirocco*, 69 P.3d 194, 197-98 (Kan. Ct. App. 2003) (covenant ancillary to employment contract); *Weber v. Tillman*, 913 P.2d 84, 89 (Kan. 1996) (covenant ancillary to employment contract); *Barton v. Hackney*, 208 P.2d 590, 594 (Kan. 1949) (covenant ancillary to sale of a business).

#### B. Legitimate Business Interest

To be enforceable, a covenant not to compete must protect the legitimate business interest of the employer. Kansas courts have not fully developed what constitutes a legitimate business interest. Kansas courts have expressly recognized that protecting “customer contacts” and “referral sources” are legitimate business interests. *Eastern Distributing Co. v. Flynn*, 567 P.2d 1371, 1372 (Kan. 1977); *Idbeis v. Wichita Surgical Specialists, P.A.*, 112 P.3d 81 (Kan. 2005). Further, Kansas courts recognize that employers have an interest in protecting trade secrets and preventing unfair competition.” *Universal Engraving, Inc. v. Duarte*, 519 F. Supp. 2d 1140 (D. Kan. 2007). The Kansas Supreme Court has also recognized the holdings of courts in other jurisdictions protecting the

special training of employees, confidential business information, trade secrets, loss of clients, good will and reputation. *Weber*, 913 P.2d at 91.

### **C. Undue Burden on Employee**

Further, a covenant may not place an undue burden on the employee. Under this factor, Kansas courts will examine whether the covenant merely restricts an employee from pursuing his chosen profession for a limited amount of time and in a limited area, or whether the covenant prevents the employee from working in his chosen profession entirely. See *Weber* at 91; *Wichita Clinic, P.A. v. Louis*, 185 P.3d 946 (Kan. Ct. App. 2008)

### **D. Injurious to the Public Welfare**

The courts also determine whether the covenant is injurious to the public welfare. Here, the Kansas courts analyze the facts and circumstances of each particular case to determine whether enforcement of the covenant will harm the public. See *Weber* at 95; *Idbeis* at 766. For example, if enforcement of this covenant will leave a community with a shortage of doctors in a particular specialty, the covenant will not be enforced. See *Weber* (citing cases from other jurisdictions that so hold). When considering a covenant's intersection with public policy, the foremost concern is that freedom to contract is not interfered with lightly. See *Graham* at 198; *Idbeis* at 766.

### **E. Reasonableness Requirements**

Finally, the restrictions must be reasonable as to time and territorial limitations. Beyond the truism that the shorter the time and the smaller the geographic area of restriction the more enforceable the covenant, Kansas courts have not developed a fixed rule regarding time and territorial limitations. Kansas courts have enforced a ten year covenant while reducing the territorial restriction to a five mile radius. *Foltz v. Struxness*, 215 P.2d 133, 137-38 (1950) (cited with approval in *Weber* at 90-91). The Kansas Supreme Court has found a two year restriction within a thirty mile radius reasonable. *Weber* at 90-91. On the other hand, another Kansas court found unreasonable a one year restriction within a fifty mile radius of a salesman's territory and reduced the territorial restriction. *Eastern Distributing Co. v. Flynn*, 567 P.2d 1371, 1374 (1977). The Court of Appeals of Kansas has noted that 2-year restrictions are common, and thus do not facially concern Kansas courts. *Graham* at 199. The Kansas Supreme Court has also noted that a relevant consideration in this analysis is the legitimate business interest being protected; the time and territorial limitations must be no greater than necessary to protect the

employer's legitimate business interests. *Weber* at 91. Clearly, this is a fact-intensive inquiry and employers must be prepared to demonstrate the reasonableness of the time and territorial limitations in light of the business interests being protected.

#### **F. Consideration**

In Kansas, a covenant not to compete must be supported by valid consideration in order to be enforceable. *Heatron, Inc. v. Shackelford*, 898 F.Supp. 1491, 1499 (D. Kan. 1995) (construing Kansas state law). "Under Kansas law, there is a rebuttable presumption that contracts are supported by consideration." *Id.* Thus, a former employee challenging a covenant not to compete must present evidence to overcome the presumption. Although the Kansas Supreme Court has not expressly ruled on the issue, it appears that continued employment may be sufficient consideration for a non-competition covenant depending on the facts of the case. *Id.*, citing *Puritan-Bennett Corp. v. Richter*, 657 P.2d 589, 592 (Kan. Ct. App. 1983), modified by 679 P.2d 206 (Kan. 1984). In *Puritan*, the Court of Appeals found that continued employment was sufficient consideration since the employee had been told that his continued employment was contingent upon signing the agreement and the employee was given promotions, increased responsibilities and greater importance in company operations after signing the agreement.

### **IV. OTHER COMMENTS**

#### **A. Court Reformation**

Under Kansas law, courts have broad equitable powers to modify covenants not to compete. See *Graham* at 200. In Kansas, a court has the equitable power to devise a remedy that extends or exceeds the terms of the parties' agreement if it is necessary to make the parties whole or to afford the injured party the protection contemplated by the agreement. *Puritan-Bennett Corp. v. Richter*, 657 P.2d 589, 593 (Kan. 1983), modified by 679 P.2d 206 (Kan. 1984). However, in *First American Investment Group, Inc. v. Henry*, 732 P.2d 792, 796-97 (Kan. Ct. App. 1987), the court held that an injunction could not be modified so as to extend the length of a restrictive covenant beyond that agreed upon by the parties where the restrained party has complied with the court's initial order. Thus, *First American* casts doubt on whether a court may extend injunctive relief past the limits set by the covenant. Kansas courts generally will enforce an unreasonable restraint to the extent it is reasonable. *Eastern Distributing Co. v. Flynn*, 567 P.2d at 1378; *Foltz* at 137-38. If a court finds, however, that the real object of the restrictive covenant is merely to avoid ordinary competition, it may refuse to modify equitably the agreement and instead

find the agreement wholly unenforceable. See *H & R Block, Inc. v. Lovelace*, 493 P.2d 205, 212 (Kan. 1972).

## **B. Attorney's Fees**

Presumably, it is possible for a prevailing party to recover attorneys' fees. However, "under Kansas law, the awarding of attorneys' fees is not authorized unless by statute or agreement of the parties." *Idbeis v. Wichita Surgical Specialists, P.A.*, 285 Kan. 485, 488 (2007). There is no generally applicable statute regarding covenants not to compete in Kansas. Thus, any recovery would have to be pursuant to agreement between the parties.

## **C. Choice of Law Provisions**

In general, Kansas courts follow the rule of *lex loci contractus*, meaning that the law of the state in which the contract was made governs interpretation and enforcement of the contract. See *Aselco, Inc. v. Hartford Ins. Group*, 21 P.3d 1011 (Kan Ct. App. 2001) However, if the contract contains an unambiguous choice-of-law provision, Kansas courts will give it effect "if the transaction at issue has a reasonable relation to that state." *Alexander & Alexander, Inc. v. Feldman*, 913 F.Supp. 1495, 1500 (D. Kan. 1996) (internal quotation omitted) (citation omitted). The same is true of forum selection clauses; if they are clear and unequivocal, they will be enforced. *Ori, Inc. v. Lanewala*, 1999 WL 1423068 (D. Kan. 1999).

## **D. Sale of Business**

Kansas courts distinguish between a restrictive covenant ancillary to an employment contract and one executed incidental to the sale of a business, the former being subject to stricter scrutiny by the courts. *H & R Block* at 211; *Eastern Distributing Co.* at 1376.

## **E. Forfeiture Provisions**

Forfeiture Provisions, also known as "claw-back" clauses, are presumably treated separately from covenants not to compete, as there are no decisions in which the two are discussed together.

## KENTUCKY

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## KENTUCKY

### V. SUMMARY OF THE LAW

It has been held in Kentucky that an agreement in restraint of trade is reasonable if, on consideration and [sic] circumstances of the particular case, the restriction is such only as to afford fair protection to the interests of the covenantee and is not so large as to interfere with the public interests or impose undue hardship on the party restricted.

*Borg-Warner Protective Services Corp. v. Guardsmark, Inc.*, 946 F. Supp. 495, 501 (E.D. Ky. 1996), *citing Central Adjustment Bureau, Inc. v. Ingram Assoc.*, 622 S.W.2d 681, 685 (Ky. Ct. App. 1971).

The policy behind enforcing noncompetition clauses is to protect businesses against employees resigning and taking valued clients with them. *Managed Health Care Assoc., v. Kethan*, 209 F.3d 923, 929 (6th Cir. 2000), *citing Central Adjustment Bureau, Inc., v. Ingram Assoc.*, 622 S.W.2d 681, 685-86 (Ky. Ct. App. 1981).

Reasonableness is to be determined generally by the nature of the business or profession and employment, and the scope of the restrictions with respect to the charter, duration, and territorial extent.

*Hall v. Willard & Woolsey, P.S.C.*, 471 S.W.2d 316, 317-18 (Ky. 1971).

[T]he interest of “the much maligned but time-honored middleman” is a legitimate one that deserves protection against disintermediation. The court observes that the middleman must find a contractual means to protect itself or the employees, clients or competitors will “opportunistically appropriate” its work product “without paying it the full value of services.”

*Borg-Warner Protective Services Corp. v. Guardsmark, Inc.*, 946 F. Supp. 495, 502 (E.D. Ky. 1996), *quoting Consultants and Designers v. Butler Service Group*, 720 F.2d 1553, 1558-59 (11<sup>th</sup> Cir. 1983).

### VI. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an Employment Contract

*Higdon Food Service, Inc. v. Walker*, 641 S.W.2d 750, 751 (Ky. 1982) (enforcing one-year time limit and restraint “within any regularly routed area of sales and services” of the employer); *Louisville Cycle & Supply Co. v. Baach*, 535 S.W.2d 230 (Ky. 1976) (enforcing eighteen-month time limit and restraint “in the same territory covered by [defendant] during his

employment with the plaintiff"); *Hall v. Willard & Woolsey, P.S.C.*, 471 S.W.2d 316 (Ky. 1971) (enforcing one-year time limit and 50-mile radius restraint); *Lareau v. O'Nan*, 355 S.W.2d 679 (Ky. 1962) (upholding a covenant prohibiting a physician from competing for five years in county); *Daniel Boone Clinic, P.S.C. v. Dahhan*, 734 S.W.2d 488, 490 (Ky. Ct. App. 1990) (enforcing eighteen-month time limit and 50-mile radius restraint in physician's employment contract); *White v. Sullivan*, 667 S.W.2d 385 (Ky. Ct. App. 1983) (enforcing 50-mile, 5-year restrictive covenant in public accounting practice case); *Central Adjustment Review, Inc. v. Ingram Assoc., Inc.*, 622 S.W.2d 681, 686 (Ky. Ct. App. 1981) (enforcing two-year restraint in favor of national collection agency where restraint did not preclude employees from working for local agency or national agency collecting different type of accounts); *Hammons v. Big Sandy Claims Serv.*, 567 S.W.2d 313 (Ky. Ct. App. 1978) (enforcing one-year covenant after reducing territory from 200-mile radius of any territory serviced by employer to 200 miles from an office where employee had worked).

#### **B. Incidental to the Sale of a Business**

*Ceresia v. Mitchell*, 242 S.W.2d 359 (Ky. 1951) (enforcing ten-year covenant after reducing territory from entire state to city and county); *Martin v. Ratliff Furniture Co., Inc.*, 264 S.W.2d 273, 275 (Ky. 1954) (enforcing non-compete agreement executed in connection with sale of business prohibiting competition for 5 years in same county); *Hodges v. Todd*, 698 S.W.2d 317 (Ky. Ct. App. 1985) (holding non-compete agreement executed in connection with sale of business enforceable despite absence of specific geographical limits and remanding for determination of reasonable geographical limits).

### **VII. GENERAL COMMENTS**

- A.** Kentucky courts recognize several protectible interests that will validate a restrictive covenant, including goodwill, protecting an investment in training, and protecting against (1) employee raiding, (2) publication of customer lists, and (3) divulging-or using confidential information. See *Higdon Food Serv. v. Walker*, 641 S.W.2d 750 (Ky. 1982) (employee raiding); *Central Adjustment Bureau*, 622 S.W.2d at 683, 686 (employee raiding, training, and business information); *Hammons v. Big Sandy Claims Serv.*, 567 S.W.2d at 315 (goodwill).
- B.** If a Kentucky court finds that a covenant is overbroad or unreasonable, it will equitably modify the covenant and enforce it as modified. *Hodges v. Todd*, 698 S.W.2d 317, 320 (Ky. Ct. App. 1985) ("Equitable considerations will prevail against a mechanistic approach as to whether the contract is divisible or indivisible"); see also *Ceresia v. Mitchell*, 242 S.W.2d at 362.

- C.** For a new employee, the mere fact of employment is sufficient to support a non-compete agreement. See *Higdon Food Service, Inc. v. Walker*, 641 S.W.2d 750, 752 (Ky. 1982); *Louisville Cycle and Supply Co. v. Baach*, 535 S.W.2d 230, 234 (Ky. 1976); *Stiles v. Reda*, 228 S.W.2d 455, 456 (Ky. 1950). Continued employment appears to be sufficient consideration for a non-compete agreement, especially if employment continues for an appreciable time after the non-compete is signed and the employee severs the relationship by voluntarily resigning. *Central Adjustment Bureau*, 622 S.W.2d at 685; *Louisville Cycle and Supply Co. v. Baach*, 535 S.W.2d at 230. *But see Crowell v. Woodruff*, 245 S.W.2d 447, 449 (Ky. 1951) (court in dictum suggests that the covenant therein "should be held without consideration since it was entered into subsequent to the contract of employment").
- D.** The Kentucky courts do not appear to have addressed whether a forfeiture of benefits provision is treated as a restraint of trade and is thus subject to the same analysis as other non-competition covenants.
- E.** Kentucky courts have not clearly decided whether a non-compete is enforceable if the employee is discharged. In *Bradford v. Billington*, 299 S.W.2d 601 (Ky. 1967), a partnership agreement provided that it could be terminated on four month's notice "for any cause." The Court enforced a six-year, county-wide non-compete agreement against the non-terminating partner after the terminating partner had ended the partnership without cause. *Id.* at 604. However, in *Orion Broadcasting, Inc. v. Forsythe*, 477 F. Supp. 198, 201 (W.D. Ky. 1979), the court refused to enforce a non-compete agreement against an employee who had been discharged "at the whim of plaintiff."
- F.** While no Kentucky case has specifically addressed the issue in the non-compete context, attorneys' fees should be recoverable if provided for in the contract. *Lyon v. Whitsett*, 245 S.W.2d 926 (Ky. 1951) ("As a general rule, in the absence of contractual or statutory liability, attorneys' fees are not recoverable as an item of damages.")
- Kentucky has adopted the Uniform Trade Secrets Act. Ky. Rev. Stat. §§ 365.880-365.900. Thus, attorneys' fees are recoverable in the circumstances set out in § 4 of the UTSA, including willful and malicious appropriation of a trade secret.
- G.** An employer's breach of the employment agreement will relieve the employee of contractual obligations not to compete. *Hemminger v. Johnson*, 1986 Ky. App. LEXIS 1455 (Ky. Ct. App. 1986); *Crowell v. Woodruff*, 245 S.W.2d 447 (Ky. Ct. App. 1952).

- H. Kentucky courts will enforce contractual choice of law provisions if two conditions are met: (1) some vital element of the contract must be associated with the state-whose laws are designated to control; and (2) the transaction must have been entered into in good faith. *Consolidated Jewelers, Inc. v. Standard Financial Corp.*, 325 F.2d 31, 34 (6th Cir. 1963); see also *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831, 837-38 (1948) (same). There is no Kentucky case applying this rule in the non-compete context.
  
- I. Kentucky has adopted the Uniform Trade Secret Act's definition of a trade secret as "information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (1) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." Ky. Rev. Stat. §§ 365.880-365.900.
  
- J. Noteworthy articles and/or publications. McClelland and Forgy, Is Kentucky Law "Pro-Business in its Protection of Trade Secrets, Confidential and Proprietary Information? A Practical Guide for Kentucky Businesses and Their Lawyers, 24 N. Ky. L. Rev. 229 (1997).
  
- K. Noteworthy cases summarizing the scope of permissible/impermissible restraints include *Higdon Food Serv. v. Walker*, 641 S.W.2d 750 (Ky. 1982); *Hodges v. Todd*, 698 S.W.2d 317, 320 (Ky. Ct. App. 1985); *Central Adjustment Bureau v. Ingram Assoc. Inc.*, 622 S.W.2d 681, 685 (Ky. Ct. App. 1981); and *Hammons v. Big Sandy Claims Serv.*, 567 S.W.2d 313 (Ky. Ct. App. 1978).

## LOUISIANA

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## LOUISIANA

### **I. Statutory Enactments**

Generally, all agreements that prevent individuals from entering into lawful professions, trades, or businesses are void in Louisiana. LA. REV. STAT. ANN. § 23:921.<sup>5</sup> In the employment context, however, limitations on the rights of

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<sup>5</sup> LA. REV. STAT. § 23:921 (Supp. 2003), in part, reads as follows:

§ 921. Restraint of business prohibited; restraint on forum prohibited; competing business; contracts against engaging in; provisions for

A. (1) Every contract or agreement, or provision thereof, by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, except as provided in this Section, shall be null and void.

(2) The provisions of every employment contract or agreement, or provisions thereof, by which any foreign or domestic employer or any other person or entity includes a choice of forum clause or choice of law clause in an employee's contract of employment or collective bargaining agreement, or attempts to enforce either a choice of forum clause or choice of law clause in any civil or administrative action involving an employee, shall be null and void except where the choice of forum clause or choice of law clause is expressly, knowingly, and voluntarily agreed to and ratified by the employee after the occurrence of the incident which is the subject of the civil or administrative action.

B. Any person, including a corporation and the individual shareholders of such corporation, who sells the goodwill of a business may agree with the buyer that the seller or other interested party in the transaction, will refrain from carrying on or engaging in a business similar to the business being sold or from soliciting customers of the business being sold within a specified parish or parishes, or municipality or municipalities, or parts thereof, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein, not to exceed a period of two years from the date of sale.

C. Any person, including a corporation and the individual shareholders of such corporation, who is employed as an agent, servant, or employee may agree with his employer to refrain from carrying on or engaging in a business similar to that of the employer and/or from soliciting customers of the employer within a specified parish or parishes, municipality or municipalities, or parts thereof, so long as the employer carries on a like business therein, not to exceed a period of two years from termination of employment. An independent contractor, whose work is performed pursuant to a written contract, may enter into an agreement to refrain from carrying on or engaging in a business similar to the business of the person with whom the independent contractor has contracted, on the same basis as if the independent contractor were an employee, for a period not to exceed two years from the date of the last work performed under the written contract.

D. For the purposes of Subsections B and C, a person who becomes employed by a competing business, regardless of whether or not that person is an owner or equity interest holder of that competing business, may be deemed to be carrying on or engaging in a business similar to that of the party having a contractual right to prevent that person from competing.

E. Upon or in anticipation of a dissolution of the partnership, the partnership and the individual partners, including a corporation and the individual shareholders if the corporation is a partner, may agree that

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none of the partners will carry on a similar business within the same parish or parishes, or municipality or municipalities, or within specified parts thereof, where the partnership business has been transacted, not to exceed a period of two years from the date of dissolution.

F. (1) Parties to a franchise may agree that:

(a) The franchisor shall refrain from selling, distributing, or granting additional franchises to sell or distribute, within defined geographic territory, those products or services which are the subject of the franchise.

(b) The franchisee shall:

(i) During the term of the franchise, refrain from competing with the franchisor or other franchisees of the franchisor or engaging in any other business similar to that which is the subject of the franchise.

(ii) For a period not to exceed two years following severance of the franchise relationship, refrain from engaging in any other business similar to that which is the subject of the franchise and from competing with or soliciting the customers of the franchisor or other franchisees of the franchisor.

(c) The employee if employed by a franchisor shall:

(i) During the term of his employment by the franchisor, refrain from competing with his employer or any of the franchisees of his employer or engaging in any other business similar to that which is the subject of the franchise.

(ii) For a period not to exceed two years following severance of the employment relationship between the franchisor and the employee, refrain from engaging in any other business similar to that which is the subject of the franchise between the franchisor and its franchisees and from competing with or soliciting the customers of his employer or the franchisees of his employer.

(2) As used in this Subsection:

(a) "Franchise" means any continuing commercial relationship created by any arrangement or arrangements as defined in 16 Code of Federal Regulations 436.2(a).

(b) "Franchisee" means any person who participates in a franchise relationship as a franchisee, partner, shareholder with at least a ten percent interest in the franchisee, executive officer of the franchisee, or a person to whom an interest in a franchise is sold, as defined in 16 Code of Federal Regulations 436.2(d), provided that no person shall be included in this definition unless he has signed an agreement expressly binding him to the provisions thereof.

(c) "Franchisor" means any person who participates in a franchise relationship as a franchisor as defined in 16 Code of Federal Regulations 436.2(c).

G. (1) An employee may at any time enter into an agreement with his employer that, for a period not to exceed two years from the date of the termination of employment, he will refrain from engaging in any

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work or activity to design, write, modify, or implement any computer program that directly competes with any confidential computer program owned, licensed, or marketed by the employer, and to which the employee had direct access during the term of his employment or services.

(2) As used in this Subsection, "confidential" means that which:

(a) Is not generally known to and not readily ascertainable by other persons.

(b) Is the subject of reasonable efforts under the circumstances to maintain its secrecy.

(3) As used in this Subsection, "computer program" means a plan, routine, or set of statements or instructions, including any subset, subroutine, or portion of instructions, regardless of format or medium, which are capable, when incorporated into a machine-readable medium, of causing a computer to perform a particular task or function or achieve a particular result.

(4) As used in this Subsection, "employee" shall mean any individual, corporation, partnership, or any other entity which contracts or agrees with an employer to perform, provide, or furnish any services to, for, or on behalf of such employer.

H. Any agreement covered by Subsection B, C, E, F, G, J, K, or L of this Section shall be considered an obligation not to do, and failure to perform may entitle the obligee to recover damages for the loss sustained and the profit of which he has been deprived. In addition, upon proof of the obligor's failure to perform, and without the necessity of proving irreparable injury, a court of competent jurisdiction shall order injunctive relief enforcing the terms of the agreement. Any agreement covered by Subsection J, K, or L of this Section shall be null and void if it is determined that members of the agreement were engaged in ultra vires acts. Nothing in Subsection J, K, or L of this Section shall prohibit the transfer, sale, or purchase of stock or interest in publicly traded entities.

I. (1) There shall be no contract or agreement or provision entered into by an automobile salesman and his employer restraining him from selling automobiles.

(2) (a) For the purposes of this Subsection, "automobile" means any new or used motor-driven car, van, or truck required to be registered which is used, or is designed to be used, for the transporting of passengers or goods for public, private, commercial, or for-hire purposes.

(b) For the purposes of this Subsection, "salesman" means any person with a salesman's license issued by the Louisiana Motor Vehicle Commission or the Used Motor Vehicle and Parts Commission, other than a person who owns a proprietary or equity interest in a new or used car dealership in Louisiana.

J. A corporation and the individual shareholders of such corporation may agree that such shareholders will refrain from carrying on or engaging in a business similar to that of the corporation and from soliciting customers of the corporation within a specified parish or parishes, municipality or municipalities, or parts thereof, for as long as the corporation carries on a similar business therein, not to exceed a period of two years from the date such shareholder ceases to be a shareholder of the corporation. A violation of this Subsection shall be enforceable in accordance with Subsection H of this Section.

K. A partnership and the individual partners of such partnership may agree that such partners will refrain

employees and independent contractors may be valid, as may agreements ancillary to the sale of a business, the dissolution of a partnership, or the formation of a franchise. To remain valid, those agreements may not exceed a term of two years. Unless explicitly mentioned in the statute, other limitations placed on an individual's right to compete are void.

In June 2003, the Louisiana Legislature amended Section 23:921(D) to clarify a conflict among the state's circuit courts regarding the breadth of statutory exceptions for sales of businesses and employment covenants. Section 23:921, as amended, now allows former employers and sellers of businesses to prevent employees and buyers from competing for themselves *and* as employees of third parties. LA. REV. STAT. ANN. § 23:921(D).

## II. LOUISIANA'S LEADING CASE LAW

Louisiana's leading non-compete cases include the following: *Richard Berry & Assocs., Inc. v. Bryant*, 845 So.2d 1263, 03-106 (La.App. 5 Cir. 4/29/03) (reasoning that non-compete agreements may be entered into by an independent contractors); *Millet v. Crump*, 687 So.2d 132, 96-639 (La. App. 5 Cir. 12/30/96), *writ denied*, 1997-3207 (La. 2/20/98) (noting that the maximum duration of non-compete ancillary to the sale of a business is two years from the date on which the sale is completed); *AMCOM of Louisiana, Inc. v. Battson*, 670 So.2d 1223, 96-0319 (La. 3/29/96) (providing that courts may strike portions of non-compete agreements that violate state law while enforcing the remaining contracts); *Walker v. Louisiana Health Mgmt. Co.*, 666 So.2d 415, 94-1396 (La. App. 1 Cir. 12/15/95), *writ denied*, 96-0571 (La. 4/19/96) (stating that the version of the statute in effect at the time of an agreement's execution controls); *SWAT 24 Shreveport Bossier, Inc. v. Bond*, 808 So. 2d 294 (La. 6/29/2001) (stating that non-compete agreements in Louisiana should be strictly construed in favor of the employee).

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from carrying on or engaging in a business similar to that of the partnership and from soliciting customers of the partnership within a specified parish or parishes, municipality or municipalities, or parts thereof, for as long as the partnership carries on a similar business therein, not to exceed a period of two years from the date such partner ceases to be a partner. A violation of this Subsection shall be enforceable in accordance with Subsection H of this Section.

L. A limited liability company and the individual members of such limited liability company may agree that such members will refrain from carrying on or engaging in a business similar to that of the limited liability company and from soliciting customers of the limited liability company within a specified parish or parishes, municipality or municipalities, or parts thereof, for as long as the limited liability company carries on a similar business therein, not to exceed a period of two years from the date such member ceases to be a member. A violation of this Subsection shall be enforceable in accordance with Subsection H of this Section.

### III. ELEMENTS OF ENFORCEABILITY

#### A. Agreements Arising In the Employment Context

##### 1. Geographical Restrictions.

The geographical restrictions in non-competition agreements must be identifiable from the agreement's language. Unlike most jurisdictions, Louisiana does not consistently apply a "reasonableness" test to determine the applicability of a non-compete's geographical restrictions. The circuit courts in Louisiana's Courts of Appeal are split on this issue. See *Restivo v. Hanger Prosthetics & Orthotics, Inc.*, 483 F. Supp. 2d 521 (E.D. La. 2007) ("There is also conflicting jurisprudence holding that the geographical restriction need only be reasonably identifiable from the provisions of the contract").

Most circuits require that the language of a non-compete adhere strictly to section 23:921, which requires that an agreement list each restricted area specifically. See *SWAT 24 Shreveport Bossier, Inc. v. Bond*, 759 So.2d 1047, 1050, 2000-1 (La.App. 2 Cir. 5/10/00), *aff'd* by 808 So.2d 294, 2001-2 (La. 6/29/01) (commenting that according to the governing statute, the parishes and municipalities in which a former employee is restricted must be listed specifically in any non-compete agreement); *Cellular One, Inc. v. Boyd*, 653 So.2d 30, 33, 94-1783 (La.App. 1 Cir., 3/3/95), *writ denied* 95-1367 (La. 9/15/95) (upholding a non-compete agreement that specifically listed the restricted geographic parishes); *AON Risk Servs. of Louisiana, Inc. v. Ryan*, 807 So.2d 1058, 1060-61, 2002-1 (La.App. 4 Cir. 1/23/02) (declaring a non-compete agreement unenforceable as overly broad where the agreement described the scope of geographic limitations as "whatever parishes, counties and municipalities" served as home to employer's operations); *Bell v. Rimkus Consulting Group, Inc. of La.*, 983 So. 2d 927 (La.App. 5 Cir. 2008) (stating that general reference in the agreement to whatever parishes, counties or municipalities the Company conducted business did not comply with the statute). *Kimball v. Anesthesia Specialists of Baton Rouge, Inc.*, 809 So.2d 405, 412-14, 2001-2 (La.App. 1 Cir. 9/28/01), *writ denied* 2001-3316 (La. 3/8/02), *and writ denied* 2001-3355 (La. 3/8/02) (holding that a provision limiting the geographic area in which a former employee could conduct business was not enforceable because the provision failed to name each parish or municipality).

Alternatively, Louisiana's Third Circuit requires only that the restricted area be identifiable from the agreement's language. See *Moore's Pump and Supply, Inc. v. Laneaux*, 727 So.2d 695, 698 1998-1049 (La.App. 3 Cir. 2/3/99) (stating that a non-compete agreement restricting the former employee from engaging in the same business as the employer in 43 parishes was not overly broad geographically where the employer operated in each of the 43 parishes); *Petroleum Helicopters, Inc. v. Untereker*, 731 So.2d 965, 966-67, 1998-1816 (La.App. 3 Cir. 3/31/99) (noting that a non-compete agreement which, in listing geographic restrictions, failed to list each parish by name was enforceable because the parishes were identifiable and the employee should have been aware of those parishes).

2. Time Restrictions.

According to section 23:921, no agreement restricting competition may last more than two years from the date on which the employment relationship ends. See *Newton and Assocs., Inc. v. Boss*, 772 So.2d 793, 795-96, 2001-1 (La.App. 5 Cir. 10/18/00), *writ denied* 2000-3162 (La. 1/12/01) (noting that the two year duration of a non-compete agreement began with the severance of employment and did not apply to the time between execution of the agreement and the end of the employment relationship); *Cellular One* at 33 (stating that the parties cannot, by mutual agreement, expand the duration of a non-compete agreement); *Sentilles Optical Servs., Div. of Senasco, Inc. v. Phillips*, 651 So.2d 395, 399, 1995-1 (La.App. 2 Cir. 3/1/95) (noting that a non-compete agreement may not exceed the two year statutory limit, which begins with the end of the employment relationship).

3. Scope of Activities Restrained.

Under section 23:921, restricted activities may apply to post-employment activities by former employees, partners, and franchisors. LA. REV. STAT. ANN. § 23:921. For those restrictions to apply, some courts hold that the non-compete agreement must specifically define the former employer's business or the restricted activities. See *Daquiri's III on Bourbon, Ltd. v. Wandfluh*, 608 So.2d 222, 224, 92-446 (La.App. 5 Cir., 10/27/92), *writ denied* 92-3072 (La. 1/8/93) (stating that a provision of a non-compete that precluded former employee from selling "frozen drinks for consumption by the general public" did not adequately define employer's business and therefore, was invalid); *LaFourche Speech & Language Servs., Inc. v. Juckett*, 652 So.2d 679, 680-81,

94-1809 (La.App. 1 Cir., 3/3/95), *writ denied* 95-0850 (La. 5/12/95) (finding that non-compete provision prohibiting the former employee from engaging in “business similar to employer” without defining the employer’s business was overly broad);

Other courts have upheld non-compete clauses failing to specifically define the employer’s business as valid when the employer engaged in business only as the name of the company implied and the employee knew the nature of the employer’s business. *Class Action Claim Servs., L.L.C. v. Clark*, 892 So. 2d 595, (La.App. 5 Cir. 12/14/2004); *Baton Rouge Computer Sales, Inc. v. Miller-Conrad*, 767 So. 2d 763, (La.App. 1 Cir. 5/23/2000). The Third Circuit has allowed restrictions to apply to competition of any kind, regardless of whether the agreement contains any specifications. *See Moores Pump and Supply, Inc. v. Laneaux*, 727 So.2d 695, 698, 1998-1049 (La.App. 3 Cir. 2/3/99) (stating that a non-compete agreement failing to define the employer’s business was enforceable because Louisiana law does not require such definition, the parties knew the nature of the plaintiff’s business upon entering into the agreement, and the agreement specified various business activities as restricted).

Additionally, agreements restricting the solicitation of customers in Louisiana are governed by the state’s non-compete laws. *See Millet*, 687 So.2d at 135 (citing *Maestri v. Destrehan Veterinary Hosp., Inc.*, 554 So.2d 805, 810 (La.App. 5th Cir. 12/13/99)).

4. Protectable Interests.

An employer’s protectable interests may include extensive training, financial information, management techniques, and trade secrets. *See Dixie Parking Serv.* at 1319. In Louisiana, trade secrets include information, formulae, patterns, compilations, programs, devices, methods, techniques, or processes deriving some independent economic value that an employer reasonably attempts to keep secret. LA. REV. STAT. ANN. § 51:1431. Customer lists, however, are not necessarily considered trade secrets. *See Millet*, 687 So.2d at 136 (finding that customer lists were not protectable trade secrets where the former employer had not actively attempted to conceal the lists). *But see Pearce v. Austin*, 465 So.2d 868, 872 (La.App. 2d Cir. 2/27/85) (stating that a former employee did not violate an agreement by relying on his memory to solicit clients).

5. Consideration.

Louisiana does not require any certain form of consideration for the execution of non-compete agreements. Continued employment serves as adequate consideration in Louisiana. See *Cellular One* at 34 (contending that a non-compete agreement was valid where an at-will employee signed the agreement in consideration for continued employment); *Dixie Parking Serv.* at 1321 (noting that a change in employment conditions may suffice for continued employment; even if an employee is demoted, sufficient consideration existed if the employee kept confidential information and continued to participate in the employer's bonus plan).

#### 6. Judicial Modification.

Louisiana courts may reform non-compete agreements to make them enforceable. The Louisiana Supreme Court has allowed the "blue pencil" approach, allowing courts to strike overly broad provisions while enforcing the remaining provisions. See *SWAT* at 1052 (deleting portions of a non-compete that violated the governing statute and examining only the remaining portions of the agreement to determine the applicability of the agreement); *AMCOM* at 1223 (striking the overly broad restrictions in a non-compete but enforcing the remaining portions); *Dixie Parking Serv.* at 1320 (honoring the parties' severability clause and striking only the portions of a non-compete agreement that violated Louisiana law); *Petroleum Helicopter* at 968 (adding parishes to enforce a non-compete agreement that did not specifically identify any with regard to the agreement's geographical scope).

However, courts in Louisiana often decline to save invalid non-competition provisions through reformation. *L&B Transp., LLC v. Beech*, 568 F. Supp. 2d 689 (M.D. La. 2008) (because of the ambiguous language of the non-compete provision, the court held that reformation of the provision was inappropriate); *Prouty*, 691 So.2d at 1388-89 (La. App. 2 Cir. 1997) (declaring an entire non-compete agreement void where the agreement's provision defining the scope of restricted activities was invalid); *Water Processing Technologies, Inc. v. Ridgeway*, 618 So.2d 533, 536 (La. App. 4 Cir. 1993).

### **B. Agreements Ancillary to the Sale of a Business.**

Non-compete agreements may not apply to a term lasting longer than two (2) years from the date of sale. *Millet* at 136 (noting that the maximum duration of non-compete ancillary to the sale of a business is two years from the date on which the sale is completed). The prohibition of

competition itself can be consideration for the sale of a business. *Marshall Brown Ins. Agency, Inc. v. Toledano*, 292 So.2d 266, 268 (La.App. 1974). See also *Hirsh v. Miller*, 167 So.2d 539, 541-42 (La.App. 7/15/64), *rev'd other grounds*, 168 So.2d 821 (La. 12/1/64) (stating that a reasonable restriction of competition is enforceable where it is part of the consideration for the sale of a business and good will). Similar to non-compete covenants in the employment context, non-compete agreements accompanying the sale of a business must identify the restricted geographic area. LA. REV. STAT. ANN. § 23:921(B).

#### **IV. EMPLOYEE USE OF CONFIDENTIAL INFORMATION**

If an employer advertises a certain employee's expertise, the employer may protect his investment in the employee by entering into a non-compete agreement that prevents the advertised employee from misusing the employer's information and secrets. Likewise, if an employer spends a substantial amount of money training an employee, the employer may execute a non-compete agreement to prevent the employee from using his specialized training to benefit a competitor. *Orkin Exterminating Co. v. Foti*, 302 So.2d 593, 596 (La. 10/28/74). However, the typical expenses associated with training, such as the time spent educating the employee through employee sales and training meetings, are not so substantial that they deserve protection through the use of non-compete agreements. *Id.* Upon surrendering protected information to their employers, former employees may rely on their memories and general knowledge that is otherwise available to the general public to solicit customers. *Pearce* at 871-72.

## MAINE

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## MAINE

### I. SUMMARY OF THE LAW

Maine courts have emphasized that covenants not to compete "are contrary to public policy and will be enforced only to the extent that they are reasonable and sweep no wider than necessary to protect the business interests in issue." Reasonableness is a question of law to be determined by the court. Reasonableness is determined by the time and space restraints imposed by the agreement, as well as the validity of the interest sought to be protected. "The reasonableness of a specific covenant must ultimately be determined by the facts developed in each case as to its duration, geographic area and the interests sought to be protected." Because "the law does not favor non-competition agreements . . . it requires that such agreements be construed narrowly and technically.

*Chapman & Drake v. Harrington*, 545 A.2d 645, 647 (Me. 1988); *Lord v. Lord*, 454 A.2d 830, 834 (Me. 1983); see also *Roy v. Bolduc*, 34 A.2d 479, 480 (1943); *Luv Homes, Inc. v. Steven Fontaine & Allstate Homes*, 1998 LEXIS 137 (Me. Super. Ct. 1998); *Prescott v. Ross*, 383 F.Supp.2d 180, 191 (D. Me. 2005) (court upheld non-competition agreement covering 100 mile radius and spanning three years) (manufacturing restriction subsequently lifted in *Prescott v. Ross*, 390 F.Supp.2d 44, 50 (D. Me. 2005)).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Chapman & Drake*, 545 A.2d at 648 (five-year non-competition covenant lacking geographic limitation reasonably advancing employer's interest upheld); *Brignull v. Albert*, 666 A.2d 82 (Me. 1995) (non-competition covenant that prevented optometrist from practicing within two miles of former employer for sixteen months upheld); *Walton v. Nalco Chemical Co.*, 1999 WL 33117055 (D. Me. 1999) (eighteen month, eleven county non-competition covenant restricting salesman of chemicals tailored to treat water in boiler systems upheld as reasonable); *Katahdin Insurance Group v. Elwell*, 2001 WL 1736572 (Me. Super. Ct. 2001) (three year non-competition covenant upheld that prevented direct or indirect solicitation of or acceptance of business from any customer with whom employee had business or personal relations); *Smith v. Maine Unemployment Ins. Comm.*, 2002 LEXIS 239 (Me. Super. Ct. 2002) (the court distinguished and found reasonable an employer rule prohibiting simultaneous employment with a competitor from non-competition agreements with a former employer (such as the agreement in *Chapman*) noting that "non-

competition agreements with a *former* employer are often (not always) viewed as against public policy because of their high potential for restricting an employee's capacity to support himself in his chosen occupation").

2. *Roy v. Bolduc*, 34 A.2d at 481 (five-year, ten-town limitation invalid where imposed on real estate agent since no valid business interest protected).

#### **B. Incidental to the sale of a business.**

1. *Emery v. Bradley*, 34 A. 167 (1896) (agreement never to engage in photography business upheld); *Flaherty v. Libby*, 81 A. 166 (Me. 1911) (five-year, one-city limitation upheld where employer's legitimate interests (customers) at stake); *Whitney v. Slayton*, 40 Me. 224 (1855) (ten-year, sixty-mile non-competition agreement upheld).
2. *Lord v. Lord*, 454 A.2d at 834-35 (seven-year, sixty-mile restriction found unreasonable where agreement was a nonconsensual court-ordered divorce settlement).

### **III. GENERAL COMMENTS**

**A. Protectible interests:** Sale of good will, trade secrets and other confidential information, customer contacts. *See Flaherty*, 81 A. at 167; *Roy*, 34 A.2d at 480-81; *Lord*, 454 A.2d at 834. *See also Brignull v. Albert*, 666 A.2d 82, 84 (Me. 1995) (noting that while "protecting an employer from business competition is not a legitimate business interest to be advanced by [a non-competition] agreement", protection of goodwill and current patients are legitimate business interests); *Prescott v. Ross*, 383 F.Supp.2d 180, 190 (D. Me. 2005) (holding that a non-competition and non-disclosure agreement protected the type of business interest that Maine law allows an employer to protect where the employee engaged in outside sales for the company, the employee had 11 years of direct personal contact with the company's customers, and the employee had the ability to affect the company's relationships with vendors).

**B. Modification:** If a covenant is overbroad, it may be modified and enforced to the extent reasonable. *Lord v. Lord*, 454 A.2d 830, 834 (Me. 1983). *See also Chapman & Drake v. Harrington*, 545 A.2d 645 (Me. 1988). Maine courts will evaluate the reasonableness of a noncompetition clause as the employer seeks to apply it, as opposed to how it is written and might have been applied. *Brignull*, 666 A.2d at 84; *Prescott v. Ross*, 383 F.Supp.2d 180, 190 (D. Me. 2005). The party seeking enforcement

cannot, however, rely on the court to redraft an overly broad provision. Rather, that party must seek to narrow the scope at the enforcement stage. *Prescott v. Ross*, 390 F.Supp.2d 44, 47 (D. Me. 2005).

- C. Attorneys' fees:** Attorneys' fees are recoverable only when provided by statute or agreement of the parties. See generally *Elliot v. Maine Unemployment Ins. Comm.*, 486 A.2d 106 (1984); *Bank of Maine N.A. v. Weisberger*, 477 A.2d 741 (1984). Under the Maine Uniform Trade Secrets Act, the court may award reasonable attorneys' fees to the prevailing party if a claim of misappropriation of trade secrets is made in bad faith, a motion to terminate an injunction is made or resisted in bad faith, or willful and malicious misappropriation exists. 10 Maine Rev. Stat. Ann. §1545.
- D. Trade secrets:** "Trade secret" is defined by the Maine Uniform Trade Secrets Act as information that "derives independent economic value, actual or potential, from not being generally known to and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use" and concerning which the owner has made "reasonable" efforts "to maintain its secrecy." 10 Maine Rev. Stat. Ann. §1542. But see *Bernier v. Merrill Air Engineers*, 770 A.2d 97 (Me. 2001) (noting that the confidential information or knowledge protected by a restrictive covenant need not be limited to information that is protected as a trade secret under the UTSA).
- E. Consideration:** Continued employment is sufficient consideration to support a non-competition covenant. See *Brignull v. Albert*, 666 A.2d 82, 84 (Me. 1995). See also *Wausau Mosinee Paper Corp. v. Magda*, 366 F.Supp.2d 212, 220 (Me. Super. Ct. 2005) (holding that a one-year period of continued employment is not required, but is adequate consideration for an otherwise reasonable covenant not to compete). In the at-will employment context in which an employee voluntarily executes a non-compete agreement after commencement of employment, a court might treat the execution of the contract and the continued performance of his or her job as the employee's acceptance of the employer's modified or renewed job offer. *Wausau Mosinee Paper Corp.* 366 F.Supp.2d at 220 (citing *Pine River State Bank v. Mettelle*, 333 N.W.2d 622, 627 (Minn. 1983) (holding that when the employee "retains employment with knowledge of new or changed conditions, the new or changed conditions may become a contractual obligation"))).
- F. Assignment:** Non-competition provisions are completely assignable and, once assigned, the assignee may enforce the agreement as if it were the original contracting party. See *Katahdin Insurance Group v. Elwell*, 2001 WL 1736572 (Me. Super. Ct. 2001).

- G. Miscellaneous:** Where the covenant not to compete is attached as an exhibit to a purchase and sale agreement, requiring separate signatures, it is not effective if unsigned, even if the parties to the purchase and sale agreement specifically allocated part of the purchase price to the covenant not to compete. See *Cushing v. Berry*, 2002 WL 465145 (Me. Super. Ct. 2002)
- H. Noteworthy articles and/or publications:** Robert Hirshon, Anti-competitive Covenants, 12 Maine Bar Bull. 1 (1978).
- I. Noteworthy cases summarizing scope of permissible/impermissible restraints:** *Chapman & Drake v. Harrington*, 545 A.2d 645 (Me. 1988); *Roy v. Bolduc*, 34 A.2d 479 (Me. 1943); *Spottiswoode v. Levine*, 730 A.2d 166 (Me. 1999); *Prescott v. Ross*, 383 F.Supp.2d 180 (D. Me. 2005).

## MARYLAND

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## MARYLAND

### I. SUMMARY OF THE LAW

The general rule in Maryland is that if a restrictive covenant in an employment contract is supported by adequate consideration and is ancillary to the employment contract, an employee's agreement not to compete with his employer upon leaving the employment will be upheld if the restraint is confined within limits which are no wider as to area and duration than are reasonably necessary for the protection of the business of the employer and do not impose undue hardship on the employee or disregard the interest of the public. *Becker v. Bailey*, 299 A.2d 835, 837-38 (Md. 1973); *Tuttle v. Riggs-Warfield-Roloson, Inc.*, 246 A.2d 588, 590 (Md. 1968).

Some factors considered in determining enforceability include: Whether the person sought to be enjoined is an unskilled worker whose services are not unique; whether the covenant is necessary to prevent the solicitation of customers or the use of trade secrets, assigned routes, or private customer lists, whether there is any exploitation of personal contacts between the employee and customer and whether enforcement of the clause would impose an undue hardship on the employee or disregard the interests of the public. *Budget Rent A Car, Inc. v. Raab*, 302 A.2d 11, 13 (Md. 1973).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Padco Advisors, Inc. v. Omdahl*, 179 F.Supp.2d 600 (D. Md. 2002) (2 year non-compete agreement with no geographic limit which barred former employee from working with two specific competitors was reasonable); *Intelus Corp. v. Barton*, 7 F.Supp.2d 635 (D. Md. 1998) (temporal term not at issue; as to geographic term, resolving question of first impression by determining that absence of geographic term is not fatal to covenant enforcement); *Holloway v. Faw, Casson & Co.*, 572 A.2d 510, 521 (Md. 1990) (covenant requiring accountant to pay his former firm a fee if he served clients within a 40-mile radius of the office was reasonable; Court of Special Appeals did not err in reducing time from five years to three years); *Budget Rent A Car, Inc.*, 302 A.2d 11 (two year restriction within the municipality in which the sub-franchisee leases cars was reasonable but was unenforceable because firm had no protectable interest); *Millward v. Gerstung Int'l Sort. Educ., Inc.*, 302 A.2d 14 (Md. 1973) (restriction limited to area immediately surrounding city of Baltimore was reasonable); *Ruhl v. F.A. Bartlett Tree Exert Co.*, 225 A.2d 288 (Md. 1967) (two-year restriction within the six county area where employee formerly worked for the employer was reasonable).

2. *United Rentals, Inc. v. Davidson*, No. 03-C-02-007061, 2002 WL 31994250 (Md. Cir. Ct. Jul. 23, 2002) (2 year duration to be overarching, and therefore, covenant is unenforceable); *Nationwide Mut. Ins. Co. v. Hart*, 534 A.2d 999 (Md. App. 1988) (covenant restricting former employees for one year after an injunction was unenforceable because it was potentially unlimited in duration); *Ecology Services Inc. v. Clym Env't'l Services, LLC*, 952 A.2d 999 (Md. App. 2008) (citing the fact that former employees did not benefit from personal contact with customers as one factor in refusing to enforce covenant; stating that personal relationships are generally not relevant in competitive bid contract situations).

#### **B. Incidental to the sale of a business.**

1. *Checket-Columbia Co. v. Lipman*, 94 A.2d 433 (Md. App. 1953) (ten-year, ten-county restraint incidental to sale of retail store, upheld); *Anderson v. Truitt*, 148 A. 223 (Md. App. 1930) (twenty-five year, county-wide restriction ancillary to the sale of a business reasonable but not enforced because individual plaintiffs were not parties to the contract containing the restrictive covenant).

### **III. GENERAL COMMENTS**

1. Protectable interests: Trade secrets, routes, client lists, established customer relationships, and goodwill. *Becker*, 299 A.2d 838; *Intelus Corp.*, 7 F.Supp.2d 639; cf. *Budget Rent A Car, Inc.*, 302 A.2d 11. Maryland will enforce restrictive covenants only against those employees who provide unique services or to prevent the misuse of trade secrets, routes or lists of clients, or solicitation of customers. *Nationwide Mut. Ins. Co.*, 534 A.2d at 1002 (citing *Becker*, 299 A.2d 835).

*But note:* Maryland employers have no protectable interest in merely preventing an increase in ordinary competition. *Intelus Corp.*, 7 F.Supp.2d at 639.

2. If a covenant is overbroad, but not deliberately unreasonable, Maryland courts are reluctant to modify and enforce it. See *Deutsche Post Global Mail, Ltd. v. Conrad*, 292 F. Supp. 2d 748, 757 (2003) (holding that blue pencil actions by the court should be limited to removal of offending language and not adding language to make covenant reasonable); *Fowler v. Printers II, Inc.*, 598 A.2d 794, 802 (Md. App. 1991); but cf. e.g., *Holloway*, 572 A.2d at 523-24 (five-year covenant reduced to three years).

3. Continued employment by itself is not sufficient consideration for a non-competition agreement. See *Tuttle*, 246 A.2d 588; *Ruhl*, 225 A.2d 290 (change in terms or conditions of employment through substitution of a new pay plan was sufficient consideration). But see *Simko, Inc. v. Graymor Co.*, 464 A.2d 1104, 1107 (Md. App.) cert. denied, 469 A.2d 452 (1983) (continuation of employment for a substantial period (nine years) beyond the threat of discharge is sufficient consideration).
4. A forfeiture of benefits provision is treated as a restraint of trade and thus is subject to the same analysis as other non-competition covenants. See, e.g., *Holloway*, 572 A.2d 510 (where the covenant did not prevent the employee from soliciting clients of his former firm, but required the employee to forfeit a portion of the fees charged to those clients); *Food Fair Stores, Inc. v. Greeliv*, 285 A.2d 632, 638 (Md. 1972) (forfeiture of benefits provision was not enforced where pension vested upon termination); *MacIntosh v. Brunswick Corp.*, 215 A.2d 222, 225 (Md. 1965).
5. Is non-compete covenant enforceable if the employee is discharged? Probably not. See *Ruhl*, 225 A.2d at 293 (where the court enforced a covenant, but noted, "[h]ad Ruhl been terminated by Barlett through no fault of Ruhl's, a different legal situation might well have been presented"); *MacIntosh v. Brunswick Corp.*, 215 A.2d 222, 225-26 (Md. 1965).
6. Will a choice of law provision in contract be followed? Generally, yes. Maryland courts will give effect to a choice of law provision unless there is no reasonable basis for the choice or the choice violates a fundamental policy of the state. *Labor Ready, Inc. v. Abis*, 767 A.2d 936 (Md. App. 2001) (giving effect to parties' choice of Washington substantive law); *CIENA Corp v. Jarrard*, 203 F.3d 312 (4th Cir. 2000) (applying Delaware substantive law); *Kronevet v. Lipchin*, 415 A.2d. 1096, 1104-05 (Md. 1980).
7. In cases involving the interpretation of a non-competition agreement, summary judgment is inappropriate unless extrinsic evidence is undisputed or only one reasonable meaning can be ascribed to the language when viewed in context. *Labor Ready*, 767 A.2d at 944 (applying Maryland procedural law)
8. Trade secrets defined: *Tabs Assocs. v. Brohawn*, 475 A.2d. 1203, 1212 (Md. App. 1984).

9. Noteworthy articles and/or publications: Restrictive Covenants in Maryland Employment Agreements: A Guide to Drafting, 11 U. Balt. L. Rev. 377 (1982).
10. Noteworthy cases summarizing scope of permissible/impermissible restraints: *Becker*, 299 A.2d 835; *Tabs Assocs.*, 474 A.2d 1203.

## **MASSACHUSETTS**

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## MASSACHUSETTS

### I. SUMMARY OF THE LAW

#### A. Covenants Ancillary to an Employment Contract

In order to be enforceable, employee noncompetition agreements must be reasonable in time and space, necessary to protect legitimate interests of the employer, and not an obstruction of the public interest. "What is reasonable depends on the facts in each case."

*Novelty Bias Binding Co. v. Shevrin*, 175 N.E.2d 374, 376 (1961).

Reasonableness of restrictions is determined with reference to "the nature of the [employer's] business . . . the character of employment involved . . . the situation of the parties, the necessity of the restriction for the protection of the employer's business and the right of the employee to work and earn

a livelihood."

*Richmond Bros. Inc. v. Westinghouse Broadcasting Co.*, 256 N.E.2d 304, 307 (Mass. 1970).

See *Ferrofluidics v. Advanced Vacuum Components*, 968 F.2d 1463, 1469 (1st Cir. 1992).

In deciding whether to enforce a particular agreement, a court should consider if the covenant (1) is necessary to protect the legitimate interests of the employer, (2) is supported by consideration, (3) is reasonably limited in all circumstances, including time and space, and (4) is otherwise consonant with public policy.

*Bowne of Boston, Inc. v. Levine*, 1997 WL 781444, at \*2 (Mass. Super. Nov. 25, 1997).

"An executive employee is barred from actively competing with his employer during the tenure of his employment, even in the absence of an express covenant so providing."

*Orkin Exterminating Company, Inc. v. Rathje*, 72 F.3d 206, 207(1<sup>st</sup> Cir. (Mass.) 1995).

"Contracts drafted by employers to limit the employment prospects of former employees – even those at a very high level – must be construed narrowly against the employer."

*Securitas Security Services USA, Inc. v. Jenkins*, 16 Mass. L. Rep. 486 (Mass. Super. 2003) (citation omitted).

Employee covenants not to compete are enforceable if reasonable based on all the circumstances. Restrictive covenants in the employment context will be enforced to the extent that the restrictions are reasonably limited in time and geographic scope and are consistent with the public interest.

*See All Stainless, Inc. v. Colby*, 364 Mass. 773, 778 (1974).

Restrictive covenants are reasonable when they are narrow in geographic scope and cover a relatively short time frame.

*Boch Toyota, Inc. v. Klimoski*, 18 Mass. L. Rep. 80, \*11 (Mass. Super. 2004) (upholding a covenant not to compete spanning a duration of twelve months and a geographic scope of thirty-five miles).

## **B. Covenants Incidental to the Sale of a Business**

Generally, courts will enforce a non-competition agreement ancillary to the sale of a business if it is reasonable in time, space, and product line and does not conflict with the public interest.

*Whitinsville Plaza, Inc. v. Kotseas*, 390 N.E.2d 243, 252 (Mass. 1979).

In determining reasonableness with respect to covenants incidental to a sale, courts look to the following factors: the amount of money paid by the buyer; the identity of the name of the seller with the name of the business; the duration and importance of the seller's association with the business; and the conduct and statements of the seller at the time of the sale.

*Tobin v. Cody*, 180 N.E.2d 652, 656 (Mass. 1962).

In the context of the sale of a business, courts look “less critically” at covenants not to compete because they do not implicate an individual’s right to employment to the same degree as in the employment context.

*Alexander & Alexander, Inc. v. Danahy*, 21 Mass. App. Ct. 488, 498 (1986).

In the context of the sale of a business, courts are less concerned with unequal bargaining power between the parties than in the employment context.

*Wells v. Wells*, 9 Mass. App. Ct. 321, 324 (1980).

A franchise agreement should be analyzed as a sale of business where the plaintiff, former owner of a franchise, gained access to the franchise company's confidential information and trademarks, received profits from the franchise, received long-term contracts of association with the franchise corporation, received protection from competition from former franchises under the terms of the very covenant not to compete that plaintiff now challenges, and voluntarily terminated the franchise agreement at a profit of \$72,000.

*Boulangier v. Dunkin' Donuts, Inc.*, 442 Mass. 635, 641 (2004).

## II. PARAMETERS OF THE "REASONABLENESS" TEST

### A. Ancillary to an employment contract.

1. Reasonable: *Blackwell v. E.M. Helides, Jr., Inc.*, 313 N.E.2d 926, 927 (Mass. 1974) (three-year, thirteen-city restriction reasonable); *Novelty Bias Binding v. Shevrin*, 175 N.E.2d 374 (Mass. 1961) (covenant prohibiting former employee/general manager from competing with his former employer in twenty-six states for a three-year period held reasonable where former employee had primary responsibility for employer's sales program in those areas); *New England Tree Expert Co. v. Russell*, 28 N.E.2d 997, 1000 (Mass. 1940) (stating that in appropriate circumstances a non-competition agreement can be enforced beyond the limits of the actual place of employment of the person concerned); *Marine Contrs. Co. v. Hurley*, 365 Mass. 280, 289 (1974) (covenant not to compete covering area within 100 miles of Boston reasonable); *Affinity Partners, Inc. v. Drees*, 1996 WL 1352635 (Mass. Super. 1996) (enforcing a two-year restriction preventing former employee from competing directly or indirectly with any business organization whose activities are directly or indirectly competitive with the employer, but the original noncompetition agreement that restricted the former employee from "working for any company whose activities or services are *similar* to those of the [employer]" was found to be unreasonable. (emphasis in original)); *Philips Electronics North America v. Halperin*, 2000 WL 33171040 (Mass. Super. 2000) (two-year nationwide restriction barring work in the narrow field of voice recognition software technology found reasonable); *Boch Toyota, Inc. v. Klimoski*, 18 Mass. L. Rep. 80, \*11 (Mass. Super. 2004) (one-year, thirty-five mile restriction reasonable because of the narrow geographic scope and relatively short time frame).

2. Unreasonable: *Richmond Bros., Inc. v. Westinghouse Broadcasting Co.*, 256 N.E.2d 304, 307 (Mass. 1970) (five-year restriction unreasonable; court refused to enforce remaining two years on a five-year non-competition agreement for a radio broadcaster where he had complied with the agreement for almost three-year period); *Wrentham Co. v. Cann*, 189 N.E.2d 559, 562 (Mass. 1963) (five-year restriction unreasonable; affirmed enforcement of non-competition agreement for three years); *All Stainless Inc. v. Colby*, 308 N.E.2d 481, 485-86 (Mass. 1974) (two-year non-competition agreement that barred competition in New England and New York found reasonable as to time but overly broad as to territory, since it was not limited to the geographic area actually served by salesman); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. DeForest*, Superior Ct., Suffolk Cty., Civ. A. No. 94-6784 (Dec. 23, 1994) (declining to issue injunction against stockbroker because of strong public policy in favor of allowing customers to use the financial consultant of their choice); *IKON Office Solutions, Inc. v. Belanger*, 59 F.Supp.2d 125, 129 (D. Mass. 1999) (two-year restriction not “categorically appropriate” when the time of employ, during which the restrictive covenants were in place, was only slightly greater than one year); *W.B. Mason Company, Inc. v. Staples, Inc.*, 2001 WL 227855 (Mass. Super. 2001) (one-year 50 or 100 mile radius restriction caused enough potential hardship to the former employees that the court modified and narrowed the breadth of the covenant to cover only those things necessary to protect the good will in issue, and it prohibited the former employees only from calling upon customers they called upon while in the employ of the former employer, for the remainder of the one-year period from the end of their employment).

## **B. Incidental to the sale of a business.**

1. Reasonable: *Tobin v. Cody*, 180 N.E.2d 652, 658 (Mass. 1962) (permanently enjoining sellers of a scrap-metal business from engaging in that type of business and from soliciting customers of purchaser, within the county of the business sold); *Alexander & Alexander, Inc. v. Danahv*, 21 Mass. App. 488 (1986) (upholding customer-based covenant for five-year period; finding it was not unreasonable to include prospective customers within the ban and finding covenants were not unreasonably restrictive despite the fact they prevented individuals from “receiving” business; holding that in the context of the sale of a business, a covenant not to compete was proper where the seller received proceeds from the business);

*Bonneau v. Meaney*, 178 N.E.2d 577, 579 (Mass. 1961) (enforcing 20-year non-competition agreement made in connection with sale of telephone answering service business); *Wells v. Wells*, 400 N.E.2d 1317, 1321 (Mass. 1980) (covenant incidental to sale of interest in homemaker service business prohibiting competition in the "greater New Bedford, Plymouth and Fall River areas" for an unlimited time enforced for a period of 52 months; agreement enforceable despite restricting defendant from competing in areas in which the business had no customers or offices when the agreement was signed); *Boulanger v. Dunkin' Donuts, Inc.*, 442 Mass. 635, 644 (2004) (rejecting the argument that the portion of a covenant not to compete prohibiting employment by a competitor within a five-mile area of a Dunkin' Donuts implicates a liberty right).

### III. GENERAL COMMENTS

- A. Protectible interests:** A covenant not to compete is reasonable if its purpose is to protect an employer's legitimate business interests, including good will, customer contacts, trade secrets, other confidential business information, and company reputation; courts will not enforce covenants designed to protect against ordinary competition. See *Marine Contrs. Co., Inc. v. Hurley*, 310 N.E.2d 915 (Mass. 1974); *Wells v. Wells*, 400 N.E.2d 1317 (Mass. 1980); *National Hearing Aid Centers, Inc. v. Ayers*, 311 N.E.2d 573 (Mass. 1974) ("[S]kill and intelligence acquired or increased and improved through experience or through instruction received in the course of employment" are not protectible interests); *Club Aluminum Co. v. Young*, 263 Mass. 223, 226-27 (Mass. 1928); *Richmond Bros., Inc. v. Westinghouse Bdcst. Co., Inc.*, 357 Mass. 106, 111 (1970) (holding that protection of an employer from ordinary competition is not a legitimate business interest, and a covenant not to compete designed solely for that purpose will not be enforced); *Marcam Corp. v. Orchard*, 885 F. Supp. 294, 299 (D. Mass. 1995) ("[A] noncompetition agreement may be enforced to protect a company's reputation and its relationship with its customers."); *Workflow Solutions, LLC v. Murphy*, 2008 Mass. Super. LEXIS 305 (2008) ("The employer's interest is usually analyzed in terms of whether there are trade secrets or other confidential information at stake, or where the employer stands to lose the goodwill of its customers if the covenant is not enforced."); *Augat, Inc. v. Aegis, Inc.*, 565 N.E.2d 415 (Mass. 1991) (gross sales and other financial information may be protectible); *New England Circuit Sales, Inc. v. Randall*, 1996 U.S. Dist. LEXIS 9748 (D. Mass. 1996) ("In deciding whether certain information is confidential and should be afforded protection, several factors are relevant including the extent to which the information is known outside of the

business, the extent of measures taken by the employer to guard secrecy of the information, and the ease or difficulty with which information could be properly acquired by others”); *EMC Corp v. Gresham*, 14 Mass. L. Rep. 128 (Mass. Super. 2001) (“Good will is a broad term and encompasses a variety of intangible business attributes such as the name, location and reputation, which tends to enable the business to retain its patronage. An employer’s positive reputation or position in the eyes of its customers is an element of good will. Good will is also generated by repeat business with existing customers. Good will is a legitimate business interest that the employer is entitled to protect.”).

- B. Modification of covenants:** Although there is some authority indicating that overbroad covenants will be modified only to the extent they are divisible, the weight of authority suggests that such covenants can be modified regardless of the severability of the contract language. See *All Stainless, Inc. v. Colby*, 308 N.E.2d 481, 482 (Mass. 1974) (“If the covenant is too broad in time, in space or in any other respect, it will be enforced only to the extent that is reasonable and to the extent that it is severable for the purposes of enforcement.”); *Kroeger v. Stop & Shop Cos., Inc.*, 432 N.E.2d 566 (Mass. 1982) (reduced time); *Wrentham Co. v. Cann*, 189 N.E.2d 559 (Mass. 1963) (reduced time and geographic scope); *Ferrofluidics v. Advanced Vacuum Components*, 968 F.2d 1463, 1469 (1st Cir. 1992) (“Massachusetts courts will not invalidate an unreasonable noncompete covenant completely but will enforce it to the extent that it is reasonable.”). See also *Sentient Jets, Inc. v. Lambert*, 15 Mass. L. Rep. 500 (Mass. Super. 2002) (court imposed limitations on defendant former employees’ business until the non-competition agreements expired because totally closing defendants down would impose on them a far greater burden than that suffered by the former employer plaintiff if no relief were granted).
- C. Consideration:** Continued employment appears to be sufficient consideration for a non-competition agreement. See *Slade Gorton & Co. v. O’Neil*, 242 N.E.2d 551 (Mass. 1968); *Economy Grocery Stores Corp. v. McMenemy*, 195 N.E. 747 (Mass. 1935); *NECX v. Glidden*, Superior Ct., Essex Cty., Civ. A. No. 93-1907C (Oct. 1994); but see *First Eastern Mortgage Corp. v. Gallagher*, 2 Mass. L. Rep. 350 (July 21, 1994) (agreement was not signed as part of original employment; rather employee signed agreement reluctantly and as a result of what he perceived to be implied threats or duress); *IKON Office Solutions, Inc. v. Belanger*, 59 F.Supp.2d 125, 131 (D. Mass. 1999) (despite *McMenemy* and *Sherman v. Pfefferkorn*, “later decisions demonstrate that, in order for a restrictive covenant to withstand scrutiny, some additional consideration ought pass to an employee upon the execution of a post-employment

agreement.” The court also states, “At bottom, the courts now appear to refuse to enforce non-competition and non-solicitation agreements when the only purported consideration is the employee’s continued employment.” However, the court partially distinguishes the case at hand by noting that the new contract with the covenant not to compete was not negotiated.)

- D. Forfeiture of benefits:** A forfeiture of benefits provision is treated as a restraint of trade and thus is generally subject to the same analysis as other non-competition covenants. *Cheney v. Automatic Sprinkler Corp. of America*, 385 N.E.2d 961, 965 (Mass. 1979).
- E. Discharge of employee:** Non-competition covenants may or may not be enforceable if the employee is discharged. See *Economy Grocery Stores Corp. v. McMenemy*, 195 N.E. 747 (Mass. 1935) (refusing to enforce a non-competition agreement where an at-will employee was discharged without just cause); *Kroeger v. Stop & Shop Cos., Inc.*, 432 N.E.2d 566 (Mass. 1982) (explaining that while termination of the employment relationship at the initiative of the employer does not itself render a noncompetition provision invalid, an inequitable discharge may render invalid an otherwise reasonable non-competition provision); see also *Sherman v. Pfefferkorn*, 135 N.E. 568 (1922) (covenant enforceable where employer terminated employment); *Philips Electronics North America v. Halperin*, 2000 WL 33171040 (Mass. Super. 2000) (a non-competition agreement may be enforced if the employee is laid off: the employee signed a Separation Agreement that explicitly stated that she would abide by the Employment Agreement, which included the non-competition clause. “It is illogical to construe the non-competition clause as inapplicable to [the employee] because she was laid off.”).
- F. Attorney’s fees:** Attorneys’ fees are recoverable only if addressed in the parties’ contract or by statute. *Lincoln St. Realty Co. v. Green*, 373 N.E.2d 1172 (Mass. 1978).
- G. Breach of employment agreement by employer:** Whether an employer’s breach of an employment agreement will relieve employee of his contractual obligations not to compete depends upon the circumstances. *Ward v. American Mut. Liability Ins. Co.*, 443 N.E.2d 1342, 1343 (Mass. 1983) (holding employer’s material breach of employment agreement discharged former employee from obligation under the covenant not to compete); *Southern New England Ice Co. v. Ferrero*, 4 N.E.2d 359 (Mass. 1936) (rejecting employee’s claim that the non-competition agreement should not be enforced because the employer had not lived up to its obligation under the contract; the Federal

Bankruptcy Act prevented employer from being in a position to comply with the employment agreement).

- H. Requisite irreparable harm for an injunction:** *Marcam Corp. v. Orchard*, 885 F. Supp. 294, 297 (D. Mass. 1995) (for the purposes of determining whether the requisite irreparable harm will occur sufficient to warrant the issuing of an injunction enforcing a non-competition agreement, courts may infer that former employees who have signed noncompetition agreements will inevitably disclose confidential information, even if it is not the intention of the former employee to do so). *Philips Electronics North America v. Halperin*, 2000 WL 33171040 (Mass. Super. 2000) (for the purposes of determining whether the requisite irreparable harm will occur sufficient to warrant the issuing of an injunction enforcing a non-competition agreement, the party seeking to enforce the agreement must establish “injury that is not remote or speculative, but is actual and imminent. An injunction will not be issued to prevent the possibility of some remote future injury; a presently existing actual threat must be shown”). *Jet Spray Cooler, Inc. v. Crampton*, 361 Mass. 835, 840 (1972) (whether a departing employee actually takes any customer or supplier lists with him is not dispositive; the employee may still be enjoined if the appropriated confidential information is merely in his or her memory); see also *Boch Toyota, Inc. v. Klimoski*, 18 Mass. L. Rep. 80, \*9 (Mass. Super. 2004). *Alexander & Alexander, Inc. v. Danahy*, 21 Mass. App. Ct. 488, 495-96 (1986) (“Unexplained delay in seeking relief for allegedly wrongful conduct may indicate an absence of irreparable harm and may make an injunction based upon that conduct inappropriate.”); see also *Exeter Group, Inc. v. Sivan*, 2005 Mass. Super. LEXIS 257, \*15-16 (2005) (plaintiff’s delay in bringing action for injunctive relief weighed against its allegation of irreparable harm).
- I. Choice-of-law provisions:** *ShIPLEY Co. Inc. v. Clark*, 728 F. Supp. 818, 825 (D. Mass. 1990) (choice-of-law provision upheld; Massachusetts law applicable to enforcement of non-competition agreement against two former employees who were conducting business in Michigan); *ShIPLEY Co., Inc. v. Kozlowski*, 926 F. Supp. 28, 30 (D. Mass. 1996) (choice-of-law provision upheld; the court applied Massachusetts law and held that it was not required to apply the law of California, where the employee was working at the time of his resignation, because California did not have a fundamental policy barring non-competition clauses where trade secrets were in issue. “[A] court must disregard a choice-of-law provision in an agreement if: (1) the other state involved has a fundamental policy against the non-compete agreement; (2) that state has a materially greater interest than the designated state in the determination of the issue of enforcement of the non-competition agreement; and (3) the other state’s

law would have applied in the absence of the choice-of-law provision in the employment agreement.”). See also *Roll Systems, Inc. v. Shupe*, 1998 U.S. Dist. LEXIS 3142 (D. Mass. 1998) (choice-of-law provision denied where California found to have a materially greater interest in resolving the dispute, as the defendant was a California resident working out of California). See also *Next Generation Vending v. Bruno*, 2008 Mass. Super. LEXIS 348 (choice-of-law provision upheld where employee worked out of Massachusetts office because Massachusetts has a strong interest in enforcing agreements made by its employees and businesses).

- J. Trade secrets defined:** *Healy v. Murphy & Son, Inc.*, 260 N.E.2d 723 (Mass. 1970) (any formula, pattern, device, or compilation of information; which is used in business of one claiming a "trade secret," and which gives him opportunity to obtain advantage over competitors who do not know it).
- K. Physician non-competes void:** Under Mass. Gen. L. ch. 112, sec. 12X, any provision in a partnership, employment or other agreement with a physician which places any restriction on his right to practice medicine in any geographic area for any period of time after the termination of such professional relationship is void and unenforceable. *Falmouth Ob-Gyn Assocs., Inc. v. Abisla*, 629 N.E.2d 291, 293-94 (Mass. 1994) (compensation for competition clause requiring departing physician to compensate former partners is void and unenforceable because the Massachusetts physician non-competition statute prohibits "any restriction" on the ability of physicians to practice). See *Parikh v. Franklin Medical Center*, 940 F.Supp. 395 (D. Mass. 1996).
- L. Nurse non-competes void:** Under Mass. Gen. L. ch. 112, sec. 74D (1993), any contract or agreement creating a partnership, employment or any other professional relationship with a registered nurse or licensed practical nurse, which includes any restriction on the right of the registered nurse to practice in any geographical area for any period of time after the termination of the partnership, employment or other such professional relationship is void and unenforceable.
- M. Broadcast Industry: non-competes void:** Under Mass. Gen. L. ch. 149, sec. 186, “[a]ny contract or agreement which creates or establishes the terms of employment for an employee or individual in the broadcasting industry, including, television stations, television networks, radio stations, radio networks, or any entities affiliated with the foregoing, and which restricts the right of such employee or individual to obtain employment in a specified geographic area for a specified period of time after termination of employment of the employee by the employer or by termination of the employment relationship by mutual agreement of the employer and the

employee or by termination of the employment relationship by the expiration of the contract or agreement, shall be void and unenforceable with respect to such provision.” This statute provides that whoever violates this provision shall be liable for attorneys’ fees. See also *Carr v. Entercom Boston, LLC et al.*, 23 Mass. L. Rep. 171 (Mass. Super. 2007) (“A right of first refusal, exercised prior to the termination of an agreement, is substantively a different concept and does not, on its face, violate [sec. 186]. It can only be a statutory violation, if at all, if the right is imposed after the agreement terminates so as to prevent competition.”).

- N. Social Workers non-competes void:** Under Mass. Gen. L. ch. 112, sec. 135C, “[a] contract or agreement creating or establishing the terms of a partnership, employment, or any other form of professional relationship with a social worker licensed under this chapter that includes a restriction of the right of the social worker to practice in any geographic area for any period of time after termination of the partnership, employment or professional relationship shall be void and unenforceable with respect to that restriction.”
- O. Attorneys non-competes void:** A lawyer may not participate in an agreement which restricts the right of a lawyer to practice law after the termination of a relationship created by the agreement. One reason for this rule is to protect the public. The strong public interest in allowing clients to retain counsel of their choice outweighs any professional benefits derived from a restrictive covenant. *Meehan v. Shaughnessy*, 404 Mass. 419 (1989). Note, however, that forfeiture provisions are not per se illegal with respect to lawyers if a law firm could demonstrate its legitimate interest in its survival and well-being justified such a clause. *Pettingell v. Morrison, Mahoney & Miller*, 426 Mass. 253 (1997) (invalidating the forfeiture provision in the case at hand due to the lack of evidence that the departures had caused or threatened to cause any harm to the firm or its continuing partners).
- P. Implied covenant not to compete:** *Abrams v. Liss*, 762 N.E.2d 862, 865 (Mass. App. 2002) (implied covenants not to compete are enforceable, if reasonable in time, space, and in their effect on the public interest. Good will passes with other assets in a sale of business context, even when the sale did not involve the entire business operation. This implies that “each party may not compete so as to derogate from what was given away.”).
- Q. Franchises:** *Grease Monkey Int’l., Inc. v. Ralco Lubrication Services, Inc.*, 24 F.Supp.2d 120 (D. Mass. 1998) (covenant not to compete with a franchisor may not apply to the individual officers, directors, or shareholders of the franchisee). *Boulanger v. Dunkin’ Donuts, Inc.*, 442 Mass. 635, 635-36 (2004) (upholding covenant not to compete stemming

from franchise agreement because “Dunkin’ Donuts was protecting the very franchise system from which plaintiff himself benefited”).

- R. Enforcement by successor corporation:** *Securitas Security Services USA, Inc. v. Jenkins*, 16 Mass. L. Rep. 486 (Mass. Super. 2003) (court would not grant successor corporation’s request for injunctive relief to uphold a non-competition provision in an employment agreement where the employee resigned before the former employer was acquired, because the employee’s agreement not to compete was made with the employer, not the successor corporation).
- S. Bankruptcy:** *Maids Int’l. v. Ward (In re Ward)*, 194 B.R. 703 (Bankr. D. Mass. 1996) (right to injunctive relief pursuant to a covenant not to compete as a “claim” within the meaning of the Bankruptcy Code).
- T. Damages:** *Oceanair, Inc. v. Katzman*, 14 Mass. L. Rep. 414 (Mass. Super. 2002) (can prove damages by showing the profits the company lost as a result of losing a former client’s business to the former employee’s new company, or in the alternative, it may show the profits gained by the former employee or new company).
- U. Chapter 93A:** *Oceanair, Inc. v. Katzman*, 14 Mass. L. Rep. 414 (Mass. Super. 2002) (violation of a non-compete agreement by a former employee falls outside the scope of Mass. Gen. L. ch. 93A, which prohibits unfair or deceptive acts or practices in the conduct of a trade or business, and which provides for the award of multiple damages and attorneys’ fees in certain cases, regardless of whether the alleged violation occurs during or after the employment relationship).
- V. Definition of “direct competition”:** *Cereva Networks, Inc. v. Lieto*, 13 Mass. L. Rep. 694 (Mass. Super. 2001) (as between two data storage companies, the companies were determined to be in direct competition not because they manufacture identical products, but because a consumer wanting or needing to update its data storage would turn only to one of these entities’ products to solve its problems. Purchasing both of these products would not be a sensible third course. In determining the meaning of direct competition, “courts have focused on the customer and to whom the product is marketed.” Direct competition is also defined as “attempting to fulfill the same need in the same marketplace.”).
- W. Non-solicitation covenants:** *Bowne of Boston, Inc. v. Levine*, 1997 WL 781444 (Mass. Super. 1997) (a non-solicitation agreement is evaluated on essentially the same standards as a non-competition agreement, and it “will be enforced only if it is reasonable, based on all of the circumstances.” The court upheld an agreement prohibiting the former

employer, for two years from the date of termination of employment, from helping a competitor of the employer solicit the business of any customer, client or individual who worked for a customer or client, who was assigned to the employee as a potential source of business of for whom the employee received sales credit during the two years prior to leaving the employer, because the employee was in a position to appropriate the company's goodwill. An employee is in a position to appropriate an employer's goodwill when the employee's close association with the former employer's customers might cause the customers to associate the service or products at issue with the employee, rather than with the employer).

- X. **Partnership non-competes may be valid:** *McFarland v. Schneider*, 1998 WL 136133 (Mass. Super. 1998) (upholding a five-year ban on providing services to clients of the partnership, but striking down the three-year ban on all competition, as it would have a significant impact on the partner's ability to earn a living and is not essential or even highly necessary to protect the partnership's legitimate interests).
- Y. **Former employee's continuing personal ties with current employees:** *Quaboag Transfer, Inc. v. Halpin*, 19 Mass. L. Rep. 257, \*12 (Mass. Super. 2005) (holding no breach of non-solicitation provision of covenant not to compete in sale of business context where former employee continued friendships and frequent social encounters with current employees whom she had known for 18 years, even if this continuing contact could give her a competitive advantage in the future if she engaged in any act of solicitation).
- Z. **Assignment:** Non-compete clauses are not assignable absent assent to such an assignment. *Securitas Security Services USA, Inc. v. Jenkins*, 16 Mass. L. Rep. 486 (Mass. Super. 2003). See also *Next Generation Vending v. Bruno*, 2008 Mass. Super. LEXIS 348 (“[U]nder Massachusetts law, a non-compete agreement is unassignable absent an express agreement permitting assignment. The burden to negotiate for an assignability clause rests with the employer -- not the employee.”) (citation omitted).
- AA. **Noteworthy articles and publications:** Reece, Employee Non-Competition Agreements and Related Restrictive Covenants: A Review and Analysis of Massachusetts Law, 76 Mass. L. Rev. 2 (1991); Hughes, Employee Non-Competition Agreements: A Review of Massachusetts Law, 1978 Mass. L. Rev. 27; Boudett, Article: The Goodwill Interest in Non-Competition Cases: Still Undefined Despite Decades of Litigation, 43 B.B.J. 6 (Sept./Oct. 1999); Reece, Department:

Legal Analysis: Employee Noncompetition Agreements: Four Recurring Issues, 46 B.B.J. 10 (Mar./Apr. 2002).

**BB. Noteworthy cases summarizing scope of permissible/ impermissible restraints:** *Middlesex Neurological Assocs. v. Cohen*, 324 N.E.2d 911 (Mass. 1975) (cited by *Falmouth Ob-Gyn Assocs., Inc. v. Abisla*, 629 N.E.2d 291, 293 (Mass. 1994) (“It seems probable that G. L. c. 112, § 12X, enacted in 1977, was a legislative response to an Appeals Court decision, *Middlesex Neurological Assocs., Inc. v. Cohen* . . . in which the court enforced a covenant restraining a physician from practicing medicine in a particular geographic area for two years after termination of his employment agreement.”)); *National Hearing Aid Centers v. Aters*, 311 N.E.2d 573 (Mass. 1974); *Abranson v. Blackman*, 166 N.E.2d 729 (Mass. 1960); *Boulanger v. Dunkin’ Donuts, Inc.*, 442 Mass. 635 (2004).

## MICHIGAN

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## MICHIGAN

### I. SUMMARY OF THE LAW

#### A. Contracts Ancillary to an Employment Relationship.

##### 1. Contracts entered before March 29, 1985.

Under Mich. Comp. Laws §445.761 (repealed by Mich. Comp. Laws §445.778, effective March 29, 1985) a contract by which a person agreed not to compete in a profession or business was illegal. *Compton v. Lepak, D.D.S., P.C.*, 154 Mich. App. 360, 397 N.W.2d 311, 313-14 (1986), *leave denied*, 428 Mich. 862 (1987). A narrow exception existed for covenants not to compete obtained from employees to whom route lists had been furnished. Those covenants were enforced if they were limited to a period of 90 days after termination and prohibited competition only within the territory that the employee had worked. Mich. Comp. Laws §445.766 (repealed).

All contracts entered before March 29, 1985 are subject to §445.761. *Compton*, 397 N.W.2d at 315-16; *Production Finishing Corp. v. Shields*, 158 Mich. App. 479, 405 N.W.2d 171, 176 (1987), *cert. denied*, 488 U.S. 955 (1988); *Burns Clinic Medical\_Center P.C. v. Vorenkamn*, 165 Mich. App. 224, 418 N.W.2d 393, 394 (1987.), *appeal denied*, 425 N.W.2d 90 (1988).

Even contracts entered into before March 29, 1985 are enforceable if they can be characterized as “anti-piracy provisions,” directed to protecting confidential information. *Merrill, Lynch, Pierce, Fenner & Smith Inc. v. Ran*, 67 F. Supp.2d 764, 774 (E.D. Mich. 1999).

##### 2. Contracts entered after March 29, 1985.

Under Mich. Comp. Laws §445.774a:

- (a) An employer may obtain from an employee an agreement or covenant which protects an employer's reasonable competitive business interests and expressly prohibits an employee from engaging in employment or a line of business after termination of employment if the agreement or covenant is reasonable as to its duration, geographical area, and the type of employment or line of business. To the extent any such agreement or covenant is found to be unreasonable in any respect, a court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited.

- (b) If a non-compete agreement entered into after March 29, 1985 is not within the scope of Mich. Corp. Laws §445.774a, it is enforceable if reasonable under the common law. *Bristol Window and Door, Inc. v. Hoogenstyn*, 250 Mich. App. 478, 650 N.W.2d 670 (Mich. Ct. App. 2002) (enforcing agreement against independent contractor) "But if considered with reference to the situation, business and objects of the parties, and in the light of all the surrounding circumstances with reference to which the contract was made, the restraint contracted for appears to have been for a just and honest purpose, for the protection of the legitimate interests of the party in whose favor it is imposed, reasonable as between them and not specifically injurious to the public, the restraint will be held valid." *Id.*

## **B. Contracts Ancillary to the Sale of a Business.**

In *Brillhart v. Danneffel*, 36 Mich. App. 359, 194 N.W.2d 63, 65-66 (Mich. Ct. App. 1971), the Court held that covenants not to compete in conjunction with the sale of a business were allowed under Mich. Comp. Laws §445.766(6) (an exception to Mich. Comp. Laws §445.761) and held that a covenant not to compete for five years within 10 miles of the business which had been sold was reasonable. Mich. Comp. Laws §445.766(6) allowed covenants not to compete in conjunction with the sale or transfer "of a trade, pursuit, avocation, profession or business or the good will thereof." *Boggs v. Couturier*, 115 Mich. App. 735, 321 N.W.2d 794, 796 (Mich. Ct. App. 1982).

Covenants made ancillary to the sale of a business are generally viewed more favorably than those made in an employment context. *Great Lakes Spice Co. v. GB Seasonings, Inc.*, Case No. 05-70387, 2005 U.S. Dist. LEXIS 29795, \*4-5 (E.D. Mich. Nov. 29, 2005).

In *WorcTess Agency, Inc. v. Lane*, 66 Mich. App. 538, 239 N.W.2d 417, 421 (1976), the Court held that the "sale of business along with its accompanying good will" creates an implied covenant not to solicit customers of the business.

## **II. PARAMETERS OF THE "REASONABLENESS" TEST**

### **A. Ancillary to an employment contract.**

Under Mich. Comp. Laws §445.774a(1), effective March 29, 1985, a covenant not to compete will be enforced if it is "reasonable as to its duration, geographical area; and the type of employment or line of business." See *United Rentals (North America), Inc. v. Keizer*, 202 F. Supp. 2d 727, 740 (W.D. Mich. 2002) (covenant unreasonable to extent it could be construed to foreclose competition outside county); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Ran*, 67 F. Supp. 2d 764, 773 (E.D. Mich. 1999) (one-year covenant against soliciting former customer

enforceable); *Robert Half Int'l, Inc. v. Van Steenis*, 784 F. Supp. 1263 (E.D. Mich. 1991) (the Court reformed an overbroad covenant to create an enforceable covenant which prohibited a defendant from competing for one year within 50 miles of two offices at which defendant had performed services).

Noncompetition agreements are disfavored as restraints on commerce and are only enforceable to the extent they are reasonable. A court must assess the reasonableness of the noncompetition clause if a party has challenged its enforceability. The burden of demonstrating the validity of the agreement is on the party seeking enforcement.

*Coates*, 741 at 545.

Michigan state and federal courts have upheld non-compete agreements covering time periods of six months to three years. *Whirlpool Corp. v. Burns*, 457 F. Supp. 2d 806, 813 (W.D. Mich. 2006). Furthermore, one Michigan court has noted that a “restriction that is not limited in its geographic scope is not necessarily unreasonable,” especially where the former employer did business in many states and several foreign countries. *Capaldi v. Liftaid Transport, L.L.C.*, No. 267981, 2006 WL 3019799, \*4 (Mich. Ct. App. Oct. 24, 2006).

However, Michigan courts have not enforced covenants not to compete when the former employee had no confidential information that would have given him an unfair competitive advantage. *Certified Restoration Dry Cleaning Network, L.L.C. v. Tenke Corp.*, 511 F.3d 535, 549 (6th Cir. 2007); see also *Whirlpool*, 457 F. Supp. 2d at 813 (preventing enforcement of non-compete when former employer had presented no evidence that former employee had disclosed or was likely to disclose confidential information or use such information in his new job with a competitor).

Other notable Michigan cases involving covenants not to compete ancillary to employment contracts include *Coates v. Bastian Bros., Inc.*, 741 N.W.2d 539, 546 (Mich. Ct. App. 2007) (enforcing covenant preventing ex-employee from competing for one year within 100 miles of former employer); *St. Clair Med., P.C. v. Borgiel*, 715 N.W.2d 914 (Mich. Ct. App. 2006) (enforcing covenant in physician’s employment contract preventing him from competing within seven miles of two clinics operated by former employer for one year); *Bristol Window and Door, Inc.*, 250 Mich. App. 478, 494, 650 N.W.2d 670, 678 (under “rule of reason,” agreement precluding competition for three years within Michigan enforceable).

## **B. Incidental to the sale of a business.**

A Michigan federal court upheld a covenant not to compete covering all states and countries in which a business had operated for a period of five years after its sale. *Great Lakes Spice Co. v. GB Seasonings, Inc.*, Case No. 05-70387, 2005 U.S. Dist. LEXIS 29795, \*4-5 (E.D. Mich. Nov. 29, 2005).

Another Michigan court enforced a five-year covenant not to compete following the sale of a business in Michigan and Ohio. *Spradlin v. Lakestates Workplace Solutions, Inc. (In re Spradlin)*, 284 B.R. 830, 836 (E.D. Mich. 2002).

A covenant not to compete for five years within 10 miles of the business which had been sold was held reasonable in *Brillhart v. Dannefel*, 36 Mich. App. 359, 194 N.W.2d 63, 65-66 (Mich. Ct. App. 1971). A covenant not to compete for three years within 12 miles of the business sold by the defendant was upheld in *Roland v. Kenzie*, 11 Mich. App. 604, 162 N.W.2d 97 (Mich. Ct. App. 1968). See generally *Alterman, Trade Regulation in Michigan: Covenants Not to Compete*, 23 Wayne L. Rev. 275, 299-305 (1977) (summarizing in tabular form sale of business cases).

### III. GENERAL COMMENTS

#### A. Protectible interests:

Mich. Comp. Laws §445.774a provides that an employer may obtain from an employee an agreement or covenant which protects an employer's "reasonable competitive business interests . . . ." Although there is little case law defining these interests, commentators suggest that they include trade secrets, corporate planning or confidential employment materials, and employee training. Golab, *Employee Non-Competition Agreements*, 67 Mich. B.J. 388, 389 (1988). Cf. *Whirlpool Corp. v. Burns*, 457 F. Supp. 2d 806, 813 (W.D. Mich. 2006) (covenant unenforceable when former employer had presented no evidence that former employee had disclosed or was likely to disclose confidential information or use such information in his new job with a competitor); *Kelsey-Haves Co. v. Maleki*, 765 F. Supp. 402, 407 (E.D. Mich. 1991) (covenant unenforceable because defendant did not have access to confidential information which could have been used on behalf of new employer).

Even when covenants not to compete were prohibited in employment relationships, Mich. Comp. Laws §445.766(6) (repealed) allowed covenants not to compete in conjunction with the sale or transfer "of a trade, pursuit, avocation, profession or business or the good will thereof." *Boggs v. Couturier*, 115 Mich. App. 735, 321 N.W.2d 794, 796 (Mich. Ct. App. 1982); see also *Cardiology Assoc. of S.W. Mich. v. Zencka*, 155 Mich. App. 632, 400 N.W.2d 606, 610 (Mich. Ct. App. 1985) (covenant not to compete unenforceable because not connected to sale of separate business interest or good will).

- B.** If a covenant is overbroad a court may limit the covenant to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited. Mich. Comp. Laws §445.774a(1). *Bristol Window & Door v. Hoogenstyn*, 650 N.W.2d 670, 678 (Mich. Ct. App. 2002); *Compton v. Lepak, D.D.S., P.C.*, 154 Mich. App. 360, 397 N.W.2d 311, 313-14 (Mich. Ct. App. 1986) (covenant without time limitation would be interpreted to have a duration of a reasonable time), *leave denied*, 428 Mich. 862 (1987); *Robert Half Int'l*,

*Inc. v. Van Steenis*, 784 F. Supp. 1263, 1273-74 (E.D. Mich. 1991) (covenant prohibiting competition within 50 miles of any of plaintiff's offices nationwide was reformed to prohibit competition within 50 miles of two offices at which defendant had performed services).

- C. Continued employment apparently constitutes sufficient consideration for a covenant not to compete if the employee's employment is at will. *Robert Half Int'l, Inc. v. Van Steenis*, 784 F. Supp. 1263, 1273 (E.D. Mich. 1991).
- D. Forfeiture of benefits provisions were enforced even before Mich. Comp. Laws §445.761 was repealed. *Tweddle v. Tweddle Litho Co.*, 80 Mich. App. 418, 264 N.W.2d 9 (Mich. Ct. App. 1978) (upholding forfeiture of profit sharing benefits where the employee engaged in activities that competed with the employer); *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 240 N.W.2d 710 (Mich. 1976) (upholding denial of a former employee's right to future participation in the employer's retirement plan where the employee entered employment of a competitor); *Production Finishing Corp. v. Shields*, 158 Mich. App. 479, 405 N.W.2d 171, 177 (Mich. Ct. App. 1987), *cert. denied*, 488 U.S. 955 (1988) (enforcing provision by which employee forfeited bonuses if employee competed within three years of termination); *Rehmann Robson & Co. v. McMahan*, 187 Mich. App. 36, 466 N.W.2d 325, 327-28 (Mich. Ct. App. 1991) (enforcing "indemnity agreements" which compelled former employees to pay former employer a penalty if former employee performed services for clients of former employer within two years following termination of employment). *But see Mackie v. State Farm Mut. Auto. Ins. Co.*, 13 Mich. App. 556, 164 N.W.2d 777, 779 (1968) (summary judgment in favor of employee seeking post-employment benefits because agreement not to compete which would have precluded receipt of benefits was void under Mich. Comp. Laws §445.761). See Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.*, concerning federal limitations on forfeiture of post-employment benefits.
- E. Michigan does not appear to have a published decision addressing the issue of whether a covenant not to compete is enforceable if the employee is discharged. However, in at least three unpublished decisions the Michigan Court of Appeals upheld the right of employers to seek enforcement of such covenants against terminated employees. See *Medhealth Systems Corp. v. Kerr*, 2001 Mich. App. LEXIS 710, \*2, 5 (Mich. Ct. App. 2001) (noting employee was fired and finding party could seek permanent injunction even though preliminary injunction had expired and contractual term had literally run while appeal was pending); *Holder v. Smith Security Corp.*, 1999 Mich. App. LEXIS 207151, \*1-22 (Mich. Ct. App. 1999) (noting defendants "either quit, was terminated or [were] laid

off” in course of affirming judgment and upholding permanent injunctive relief); *Buckley v. Rish*, 1997 Mich. App. LEXIS 1938, \*3, 6-9 (Mich. Ct. App. 1997) (noting that contract was terminated for cause by plaintiff, reversing finding that damage claim for expired covenant was moot). While these cases are not citable as precedent, there is also no indication that termination (outside of the context of breach by the employer, see *infra*) is a defense to enforcement.

- F. Michigan does not appear to have addressed the specific issue of whether attorneys' fees are recoverable if a covenant not to compete provides for an award of those fees upon breach. In *Central Transport, Inc. v. Fruehauf Corp.*, 139 Mich. App. 536, 362 N.W.2d 823, 829 (Mich. 1984) (awarding attorneys' fees granted under equipment lease), the court held that contractual provisions for payment of reasonable attorneys' fees are judicially enforceable and are considered part of the damage award, not part of costs.
- G. Michigan does not appear to have addressed the issue of whether an employer's breach of the employment agreement will relieve the employee from his contractual obligations not to compete. As a general rule, the party which commits the first material breach of a contract cannot maintain an action against the other contracting party for failure to perform. *Ehlinser v. Bodi Lake Lumber Co.*, 324 Mich. 77, 36 N.W.2d 311, 316 (Mich. 1949). At least two federal district courts sitting in diversity have cited the first breach defense to enforcement of covenants not to compete, one in the context of an employee and the other in the context of a franchisee, based on general Michigan contract law. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ran*, 67 F. Supp. 2d 764, 776 (E.D. Mich. 1999) (citing *Baith v. Knapp-Stiles, Inc.*, 380 Mich 119, 126, 156 N.W. 2d 575, 578 (Mich. 1968) but finding insufficient evidence of a contractual breach by the employer); cf. *P.A.L. Investment Group, Inc. v. Staff-Builders, Inc.*, 118 F. Supp. 2d 781, 786-88 and n. 2 (E.D. Mich. 2000) (citing *Merrill Lynch* and *Baith* and finding that undisputed failure of franchisor to pay franchisee royalties prevented finding likelihood of success on the merits, denying entry of preliminary injunction based on same).
- H. No Michigan court appears to have addressed the question of whether a choice of law provision will be enforced in a covenant not to compete. Diversity cases decided before Mich. Comp. Laws §445.761 was repealed suggested that Michigan would not honor such clauses in covenants not to compete. See, e.g. *Muma v. Financial Guardian, Inc.*, 551 F. Supp. 119 (E.D. Mich. 1982) (decided), in which the Court refused to enforce covenant not to compete (which did not contain a choice of law provision) executed in Missouri by Missouri residents because the former employee

resided in Michigan at time of suit and Michigan public policy precluded enforcement of covenants not to compete. More recent cases suggest that such clauses will typically be honored. See *Superior Consulting, Inc. v. Walling*, 851 F. Supp., 839, 846-47 (E.D. Mich. 1994), which found that the choice of Michigan law clause in contract between Michigan company and Texas resident employee invoked Michigan substantive law and not just Michigan choice of law rules. *Lowry Computer Products, Inc. v. Head*, 984 F. Supp. 1111 (E.D. Mich. 1997), followed a choice of law provision specifying Michigan law in dispute between Michigan company and California employee based both on the logic of *Superior Consulting*, and an independent analysis under Restatement (Second) of Conflict of Laws §§ 187-88. Additionally, district courts have applied choice of law clauses specifying non-Michigan substantive law in disputes involving Michigan residents. See *Neveux v. Webcraft Technologies, Inc.*, 921 F.Supp. 1568, 1571 (E.D. Mich. 1996), which analyzed the covenant's enforceability under specified New Jersey law.

- I. In 1998, Michigan adopted the Uniform Trade Secrets Act. Mich. Comp. Laws § 445.1901 *et seq.* Prior to the adoption of the UTSA, Michigan applied the definition of a trade secret set forth in the Restatement of Torts §757 comment b. *Hayes Albion Corp. v. Kuberski*, 421 Mich. 170, 364 N.W.2d 609, 614 (1984), *reh'g denied*, 421 Mich. 1202 (1985).
- J. Noteworthy articles and/or publications: Pynnonen, *Ohio and Michigan Law on Post-Employment Covenants Not to Compete*, 55 Ohio St. L. J. 215 (1994); Golab, Employee Non-Competition Agreements, 67 Mich. B. J. 388 (1988); Cornelius, Michigan's Law of Trade Secrets and Covenants Not to Compete: Chapter Two, 66 U. Det. L. Rev. 33 (Fall 1988); Cornelius, Supreme-Court, Legislature Say "Yes" to Michigan's Trade Secrets - Michigan's Law of Trade Secrets and Covenants Not to Compete After Haves-Albion and Repeal of the Non-Compete Statute, 64 U. Det. L. Rev. 1-227 (Fall 1986).
- K. Noteworthy cases summarizing scope of permissible/impermissible restraints: *Robert Half Int'l. Inc. v. Van Steenis*, 784 F. Supp. 1263, 1273-74 (E.D. Mich. 1991) (enforcing covenant not to compete which prohibited competition for one year within 50 miles of two offices at which defendant had performed services); *Brillhart v. Dannefel*, 36 Mich. App. 359, 194 N.W.2d 63, 65-66 (Mich. Ct. App. 1971) (covenant not to compete for five years within 10 miles of the business which had been sold was reasonable).

## MINNESOTA

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## MINNESOTA

### I. OVERVIEW OF THE LAW

#### A. Statutory Statement of the Law

Not applicable.

#### B. Judicial Statement of the Law

Minnesota has long recognized the importance of employee mobility and the risks associated with an undue restraint of trade caused by post-employment restrictive covenants. *See, e.g., Mentor Co. v. Brock*, 180 N.W. 553, 555 (Minn. 1920) (the right to labor is the “most important right” a person possesses and the deprivation of this right “is ruin”). More recently, Minnesota’s Supreme Court emphasized that non-competes are “looked upon with disfavor, cautiously considered and carefully scrutinized.” *Bennett v. Storz Broadcasting Co.*, 134 N.W.2d 892, 898 (Minn. 1965). The Court emphasized the importance of the “right of the employee to work and to earn a livelihood and better his status . . .” *See also, Ecolab , Inc. v. Gartland*, 537 N.W.2d 291, 294 (Minn. Ct. App. 1995)(“The court dislikes and closely scrutinizes non-compete agreements, because they partially restrict trade.”).

Despite these periodic judicial pronouncements on the problems associated with post-employment restrictive covenants, Minnesota courts will enforce these contractual agreements when they are carefully linked to legitimate corporate interests, and when they are reasonable. “Reasonableness” is measured by the nature and scope of the substantive, geographic and temporal restrictions. The test in Minnesota is “whether or not the restraint is necessary for the protection of the business or good will of the employer, . . . whether the stipulation has imposed upon the employee any greater restraint than is necessary to protect the employer’s business [taking into consideration] the nature and character of the employment, the time for which the restriction is imposed, and the territorial extent of the locality to which the prohibition extends.” *Bennett, supra*, 134 N.W.2d 892, 899-900. *See, Medtronic, Inc. v. Gibbons*, 527 F. Supp. 1085 (D. Minn. 1981); *Jim W Miller Constr., Inc. v. Schaefer*, 298 N.W.2d 455, 458 (Minn. 1980); *Davies & Davies Agency, Inc. v. Davies*, 298 N.W.2d 127, 131 (Minn. 1980).

### II. CONSIDERATION ISSUES

#### A. Consideration Generally

If the covenant is not made ancillary to the initial employment contract, it can be sustained only if it is supported by independent consideration.

*Modern Controls Inc. v. Andreadakis*, 578 F.2d 1624 (8<sup>th</sup> Cir. 1978)(non-compete signed nine weeks after start date unenforceable); *Timm and Associates, Inc. v. Broad*, 2005 WL 3241832 (D. Minn. 2005)(non-compete signed three weeks after start date not ancillary); *Sanborn Mfg. Co. v. Currie*, 500 N.W.2d 161 (Minn. App. 1993)(where offer letter did not include reference to non-compete and employee asked to sign upon reporting to work, no consideration). See also, *National Recruiters, Inc. v. Cashman*, 323 N.W.2d 736, 740 (Minn. 1982) (where employee not informed of non-compete until reporting to work, no consideration); *Jostens, Inc. v. Nat'l Computer Sys.*, 318 N.W.2d 691, 703 (Minn. 1982).

## **B. Continued Employment**

Continued employment can be sufficient consideration if the covenant is bargained for and if it provides the employee with “substantial economic and professional benefits.” Such benefits could include increased wages, a promotion, a contract of guaranteed, long-term employment, or access to information that otherwise would not have been provided. *Freeman v. Duluth Clinic Ltd.*, 334 N.W.2d 626, 630 (Minn. 1983); *Davies & Davies Agency, Inc. v. Davies*, 298 N.W.2d 127, 130 (Minn. 1980); *Satellite Indus. Inc. v. Keeling*, 396 N.W.2d 635, 639 (Minn. Ct. App. 1986); *Modern Controls, Inc. v. Andreadakis*, 578 F.2d 1264, 1267 (8th Cir. 1978); *Minnesota Min. and Mfg. Co. v. Kirkevold*, 87 F.R.D. 324, 332 (D. Minn. 1980). As the court stressed in *Davies & Davies Agency, Inc.*, the “adequacy of consideration for a non-competition contract or clause in an ongoing employment relationship should depend on the facts of each case.” 298 N.W.2d at 130. See, *Tenant Construction, Inc. v. Mason*, 2008 WL 314515 (Minn. Ct. App. 2008)(ongoing employment conditioned on the execution of the non-compete, coupled with \$500, constituted adequate consideration); *Witzke v. Mesabi Rehabilitation Services, Inc.*, 2008 WL 614353 (Minn. Ct. App. 2008)(continued employment over 17 years, involving promotions, salary increases, professional development, constituted adequate consideration, when non-compete was specifically bargained for).

## **C. Severance Compensation**

Severance compensation may constitute adequate consideration to support post-employment restrictive covenants. See, *West Publishing Corp. v. Stanley*, 2004 WL 73590 (D. Minn. 2004)(\$200,000 in severance pay adequate consideration for one year non-compete agreement).

## **III. PARAMETERS OF THE GOVERNING STATUTE AND THE “REASONABLENESS TEST” AS APPLICABLE**

## A. Ancillary to an employment contract.

### 1. Held Enforceable

- *Vital Images, Inc. v. Martel*, 2007 WL 3095378 (D. Minn. 2007) (18-month non-competes enforceable);
- *Hutchinson Tech. Corp. v. Magnecorp Corp.*, Civ. No. 06-1703 (D. Minn. July 17, 2006) (holding reasonable a two-year non-compete in an industry which is “dominated by a relatively small number of manufacturers”);
- *Millard v Elec. Cable Specialists*, 790 F. Supp. 857, 859 (D. Minn. 1992) (1-year, nationwide restraint held reasonable);
- *Minnesota Min. & Mfg. Co. v. Kirkevold*, 87 F.R.D. 324, 332-34 (D. Minn. 1980) (2-year, nationwide restriction deemed reasonable);
- *Walker Employment Service Inc. v. Parkhurst*, 219 N.W.2d 437, 442 (Minn. 1974) (single county, one-year restriction held reasonable);
- *Overholt Crop Ins. Service v. Bredeson*, 437 N.W.2d 698, 703 (Minn. Ct. App. 1989) (2-year, 6-county restriction was reasonable);
- *Creative Communications Consultants, Inc. v. Gaylord*, 403 N.W.2d 654 (Minn. Ct. App. 1987) (one year prohibition against soliciting or servicing former employer's customers upheld);
- *Alside, Inc. v. Larson*, 220 N.W.2d 274 (Minn. 1974) (2-year restriction reasonable).

### 2. Held Unenforceable

- *Davies & Davies Agency. Inc. v. Davies*, 298 N.W.2d 127 (Minn. 1980) (three 5-year, 50-mile restrictions modified to single 1-year, county-wide restraint);
- *Dean Van Horn Consulting Assoc. v. Wold*, 395 N.W.2d 405 (Minn. Ct. App. 1986) (3-year restriction excessive and unreasonable);

- *Klick v. Crosstown State Bank of Ham Lake*, 372 N.W.2d 85, 88 (Minn. Ct. App. 1985) (3-year temporal restriction unreasonable);
- *Harris v. Bolin*, 247 N.W.2d 600, 603 (Minn. 1976) (forfeiture provision unlimited as to time and geographic area held unenforceable).

**B. Incidental to the sale of a business.**

1. *Arthur J. Gallagher & Co. v. Youngdahl*, 412 F. Supp.2d 1013 (D. Minn. 2006) (when incidental to sale of business, “reasonableness” test subject to less rigorous analysis).
2. *Sealock v. Peterson*, 2008 WL 314146 (Minn. Ct. App. 2008) (non-compete enforced in connection with the sale of an optometry practice; prohibition against “competition” included advertising in restricted territory).
3. *B & Y Metal Painting, Inc. v. Ball*, 279 N.W.2d 813, 815 (Minn. 1979) (3-year, 100-mile restriction held reasonable); *Faust v. Parrott*, 270 N.W.2d 117 (Minn. 1978) (100-mile, 10-year minimum restriction upheld); *Saliterman v. Finney*, 361 N.W.2d 175 (Minn. App. 1985) (3-year, 3-mile restriction against practicing dentistry held reasonable).
4. *Bess v. Bossman*, 257 N.W.2d 791, 794 (Minn. 1977) (restriction unlimited in time and territory deemed unreasonable; modified to 5-year, city-wide restraint).

**IV. GENERAL COMMENTS**

- A. Assignment:** Assignment rights dependent on contract language. See *Inter-Tel, Inc. v. CA Communications, Inc.*, Civ. File No. 02-1864, 2003 WL 23119384 (D. Minn. 2003) (in Minnesota, “a finding of assignability likely depends on the language of the contract”); *Saliterman v. Finney*, 361 N.W.2d 175 (Minn. Ct. App. 1985) (limited restrictive covenant, including assignment clause, enforceable).
- B. Attorneys’ Fees:** See *Cherne Indus., Inc. v. Grounds & Assoc.*, 278 N.W.2d 81, 95 (Minn. 1979) (attorneys’ fees generally not recoverable unless provided by statute or contractual provision); see also Minn. Stat. § 325C.01, *et seq.* (attorneys’ fees may be recovered under the Uniform Trade Secrets Act). See, *Kallok v. Medtronic, Inc.*, 573 N.W. 2d 356

(Minn. 1998) (attorneys' fees recoverable under tortious interference with contract analysis).

- C. Benefit Forfeiture:** A forfeiture of benefits provision is treated as a restraint of trade and thus is subject to the same analysis as other noncompetition covenants. *Bellboy Seafood Corp. v. Nathanson*, 410 N.W.2d 349, 352 (Minn. Ct. App. 1987); *Harris v. Bolin*, 247 N.W.2d 600, 601 (Minn. 1976); *National Recruiters, Inc. v. Cashman*, 323 N.W.2d 736, 741 (Minn. 1982).
- D. Choice of Law:** Choice of law provision in contract generally will be followed. *Surgidev Corp. v. Eye Technology, Inc.*, 648 F. Sup. 661, 679 (D. Minn. 1986).
- E. Compensating Employee for Not Working:** Non-competition provision that provided for compensation to employee during period of unemployment that was attributable to non-compete was enforceable (Minnesota court applying Arkansas law under choice of law provision). Summary judgment for employee affirmed. *Bannister v. Bemis Co.*, No.08-1634 (8<sup>th</sup> Cir. February 2009).
- F. Employer Breach:** Will employer's breach of the employment agreement relieve employee of contractual obligations not to compete? It depends upon the circumstances of the case, e.g., whether the employee waived the breach by acknowledging the validity of the contract after the breach occurred. See *Creative Communications Consultants, Inc. v. Gaylord*, 403 N.W.2d 654, 657 (Minn. Ct. App. 1987); *Marso v. Mankato Clinic, Ltd.*, 153 N.W.2d 281 (Minn. 1967).
- G. Equitable Modification:** If a noncompetition covenant is overbroad, it can be equitably modified. See, *Vital Images, Inc. v. Martel*, 2007 WL 3095378 (D. Minn. 2007) (agreements modified to make reasonable); *Management Recruiters International v. Professional Placement Services*, 1992 WL 61542 (Minn. Ct. App. 1992); *Bess v. Bothman*, 257 N.W.2d 791, 794 (Minn. 1977); *Davies & Davies Agcy. Inc. v. Davies*, 298 N.W.2d 127, 131 n.1 (Minn. 1980).
- H. Protectible interests:** Sale of good will, trade secrets (and other confidential information), and customer contacts. *Cherne Indus. Inc. v. Grounds & Assoc.*, 278 N.W.2d 81, 92 (Minn. 1979); *Saliterman v. Finney*, 361 N.W.2d 175, 178 (Minn. Ct. App. 1985); *Webb Pub. Co. v. Fosshage*, 426 N.W.2d 445, 449 (Minn. Ct. App. 1988); *Overholt Crop Ins. Service v. Bredeson*, 437 N.W.2d 698, 703 (Minn. Ct. App. 1989); *Bennett v. Storz Broadcasting Co.*, 134 N.W.2d 892, 898 (Minn. 1965); *Jim W. Miller Const. Inc. v. Schaefer*, 298 N.W.2d 455, 459 (Minn. 1980).

- I. **Trade secrets defined:** Minn. Stat. § 325C.01. (based on Uniform Trade Secrets Act); see also *Electro-Craft Corp. v. Controlled Motion Inc.*, 332 N.W.2d 890, 897-903 (Minn. 1983); *Medtronic, Inc. v. Advanced Bionics Corp.*, 630 NW 2d 438 (Minn. App. 2001).
  
- J. **Wrongful Discharge:** A noncompete covenant probably is not enforceable if the employee is wrongfully discharged. *Edin v. Jostens Inc.*, 343 N.W.2d 691, 693 (Minn. Ct. App. 1984).

## MISSISSIPPI

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## MISSISSIPPI

### I. STATUTORY REGULATION

None.

### II. MISSISSIPPI'S LEADING CASE LAW REGARDING NON-COMPETE AGREEMENTS

Mississippi's leading non-compete cases include the following: *Redd Pest Control Co. v. Foster*, 761 So.2d 967 (Miss. Ct. App. 2000) (balancing the interests of the public, the employer, and the employee in examining a non-compete agreement to determine the agreement's enforceability, per Mississippi law); *Empiregas, Inc. v. Bain*, 599 So.2d 971 (Miss. 1992) (stating that a court may refuse to enforce a non-compete agreement if the employee's termination was arbitrary, capricious, or in bad faith).

### III. ELEMENTS OF ENFORCEABILITY

#### A. Employment Context.

##### 1. Geographical Restrictions.

Mississippi courts will enforce "reasonable" geographical limitations in non-compete agreements. *Empiregas* at 975. In drafting a "reasonable" agreement, the parties to a non-compete must tailor the agreement's geographical scope to meet the specific needs and customer base of the employer. Hence, the reasonableness of each non-compete depends on the facts presented in the particular situation. Mississippi courts consider many factors in analyzing the reasonableness of an agreement's geographical limitations. Customer lists, for example, may serve as substitutes for specified territorial restrictions. See *Taylor v. Cordis Corp.*, 634 F. Supp. 1242, 1249 (S.D. Miss. 1986). Parties may also limit the geographical scope of an agreement according to areas of operation and reasonable expectations of expansion. See also *Kennedy v. Metropolitan Life Ins. Co.*, 759 So.2d 362, 364, 1998-CA-01007-SCT (Miss. 2000) (stating that the validity and the enforceability of a non-competition agreement are largely predicated upon the reasonableness and specificity of its terms, primarily, the duration of the restriction and its geographic scope).

##### 2. Time Restrictions.

For any time period stated in a non-compete, an employer must provide evidence supporting the reasonableness and necessity of

the chosen term; employers must therefore produce evidence of the amount of time and expense exhausted in training the former employee, the amount of time a novice might spend acquiring necessary skills and training, and the amount of time and expense the employer incurs in finding a suitable replacement for the employee. See *Herring Gas*, 813 F. Supp. 1239, 1246 (S.D. Miss. 1993) *aff'd* 22 F.3d 603 (5th Cir. 1994) (upholding a term lasting six years).

3. Scope of Activities Restricted.

In Mississippi, non-competes can restrict competition in virtually all industries and professions so long as they are “reasonable.” In determining reasonability, courts analyze interests held by the employer, the employee, and the public. See *Field v. Lamar*, 822 So.2d 893, 901-02 (Miss. 2002) (reasoning a physician’s right to practice could not be restricted where such restriction affected patients’ rights to choose a physician). Any activity that utilizes information taken from a former employer may become subject to reasonable restrictions. See *Taylor* at 1248. See also *Frierson v. Sheppard Bldg. Supply Co.*, 154 So.2d 151, 169-70 (Miss. 1963) (stating that an agreement listing the prohibited acts was sufficient in defining such acts).

4. Protectable Interests.

An employer’s protectable interests include protection of the customer base, protection of good will, the ability to succeed in a competitive market, the time and expense of training, the customer’s reliance on the employee’s skill and training, the protection of trade secrets, and the protection of confidential and proprietary business information. The Mississippi Uniform Trade Secrets Act, MISS. CODE ANN. § 75-26-1 to 75-26-19 governs the protection of trade secrets, which include formulae, patterns, compilations, programs, devices, methods, techniques, and processes that derive some independent economic value that the employer reasonably attempts to keep secret. MISS. CODE ANN. § 75-26-3. See *Union Nat. Life Ins. Co. v. Tillman*, 143 F. Supp. 2d 638, 644 (N.D. Miss. 2000).

5. Consideration.

Continued employment constitutes sufficient consideration for non-compete agreements in Mississippi. *Frierson* at 167. Competing employees may not rely on the defense of “lack of consideration”

because this defense is unavailable in Mississippi. Nevertheless, employees fired shortly after entering into non-compete agreements may be able to argue that the agreement was not supported by consideration. Mississippi courts have not identified any time period as a requirement to considering continued employment as sufficient consideration. See generally *Empiregas* at 977 (stating that continued employment and good behavior served as adequate consideration in non-compete agreements and that lack of consideration was not a valid defense).

6. Judicial Modification.

Mississippi courts apply the “blue pencil” approach in reforming non-compete agreements to modify contract provisions deemed unreasonable. See *Hensley v. E.R. Carpenter Co.*, 633 F.2d 1106, 1110 (5th Cir. 1980). This means that unreasonable terms may be stricken, but the court may still enforce the covenant according to reasonable terms. *Id.*

**B. Sale of Business Context.**

In Mississippi, a different standard applies to non-compete agreements evolving from the sale of business than for those arising out of an employment relationship. Mississippi courts are more willing to honor non-competes arising out of the sale of a business than in a general employment relationship, reasoning that a departing employee’s need for flexibility in finding a new job within the employment context is greater than the needs of an adequately compensated seller in the sale of a business. See *Cooper v. Gidden*, 515 So.2d 900, 905 (Miss. 1987) (stating that the court would scrutinize the reasonableness of a non-compete to a lesser degree in the sale of a business’s goodwill rather than in the employment context). Courts apply the same legal principles to the sale of business and employment contexts; however, courts apply that law more broadly when analyzing a non-compete covenant in the sale of a business.

**IV. EMPLOYEE USE OF CONFIDENTIAL INFORMATION**

Employees may be liable for misappropriation of trade secrets even if they use the secret in a form different from that which the employee received from the employer. Accordingly, an employee may be held liable for modifying or improving secrets, even if the improvements result from the employee’s own efforts. Differences in detail alone cannot preclude liability. *Cataphote Corp. v. Hudson*, 422 F.2d 1290, 1294-95 (5th Cir. 1970).



## MISSOURI

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## MISSOURI

### I. OVERVIEW OF THE LAW

#### A. Statutory Statement of the Law

28 Mo. Stat. Ann. § 431.202, which went into effect July 1, 2001, provides:

1. A reasonable covenant in writing promising not to solicit, recruit, hire or otherwise interfere with the employment of one or more employees shall be enforceable and not a restraint of trade pursuant to subsection 1 of section 416.031, if:
  - (a) Between two or more corporations or other business entities seeking to preserve workforce stability (which shall be deemed to be among the protectable interests of each corporation or business entity) during, and for a reasonable period following, negotiations between such corporations or entities for the acquisition of all or a part of one or more of such corporations or entities;
  - (b) Between two or more corporations or business entities engaged in a joint venture or other legally permissible business arrangement where such covenant seeks to protect against possible misuse of confidential or trade secret business information shared or to be shared between or among such corporations or entities;
  - (c) Between an employer and one or more employees seeking on the part of the employer to protect:
  - (d) Confidential or trade secret business information; or
  - (e) Customer or supplier relationships, goodwill or loyalty, which shall be deemed to be among the protectable interests of the employer; or
2. Between an employer and one or more employees, notwithstanding the absence of the protectable interests described in subdivision (3) of this subsection, so long as such covenant does not continue for more than one year following the employee's employment; provided, however, that this subdivision shall not apply to covenants signed by employees who provide only secretarial or clerical services.
3. Whether a covenant covered by this section is reasonable shall be

determined based upon the facts and circumstances pertaining to such covenant, but a covenant covered exclusively by subdivision (3) or (4) of subsection 1 of this section shall be conclusively presumed to be reasonable if its post-employment duration is no more than one year.

4. Nothing in subdivision (3) or (4) of subsection 1 of this section is intended to create, or to affect the validity or enforceability of, employer-employee covenants not to compete.
5. Nothing in this section shall preclude a covenant described in subsection 1 of this section from being enforceable in circumstances other than those described in subdivisions (1) to (4) of subsection 1 of this section, where such covenant is reasonably necessary to protect a party's legally permissible business interests.
6. Nothing in this section shall be construed to limit an employee's ability to seek or accept employment with another employer immediately upon, or at any time subsequent to, termination of employment, whether said termination was voluntary or nonvoluntary.
7. This section shall have retrospective as well as prospective effect.

## **B. Judicial Statements of the Law**

1. Restrictive covenants are not favored in the law because they restrain trade so they are only enforceable to protect a legitimate business interest. *AEE-EMF, Inc. v. Passmore*, 906 S.W.2d 714, 719 (Mo. App. W.D. 1995).
2. "There are at least four valid and conflicting concerns at issue in the law of non-compete agreements. First, the employer needs to be able to engage a highly trained workforce to be competitive and profitable, without fear that the employee will use the employer's business secrets against it or steal the employer's customers after leaving employment. Second, the employee must be mobile in order to provide for his or her family and to advance his or her career in an ever-changing marketplace. This mobility is dependent upon the ability of the employee to take his or her increasing skills and put them to work from one employer to the next. Third, the law favors the freedom of parties to value their respective interests in negotiated contracts. And, fourth, contracts in restraint of trade are unlawful." *Payroll Advance, Inc. v.*

*Yates*, 270 S.W.3d 428, 434 (Mo. App. S.D. 2008) (citing *Healthcare Servs. of the Ozarks, Inc. v. Copeland*, 198 S.W.3d 604, 609-610 (Mo. 2006)).

3. Protectable interests include the stability of an employer's workforce, the sale of goodwill, customer contacts and relationships, trade secrets, and perhaps other confidential information not rising to level of a trade secret. 28 Mo. Stat. Ann. § 431.202; *Systematic Bus. Servs., Inc. v. Bratten*, 162 S.W.3d 41, 51 (Mo. App. W.D. 2005) (customer lists need not be secret to be protected); *Easy Returns Midwest, Inc. v. Schultz*, 964 S.W.2d 450, 453 (Mo. App. E.D. 1998); *Refrigeration Indus., Inc. v. Nemmers*, 880 S.W.2d 912 (Mo. App. W.D. 1994); *Osage Glass Inc. v. Donovan*, 693 S.W.2d 71 (Mo. 1985); *Mid-States Paint & Chemical Co. v. Herr*, 746 S.W.2d 613, 617 (Mo. App. E.D. 1988); *Orchard Container Corp. v. Orchard*, 601 S.W.2d 299, 303 (Mo. App. E.D. 1980). See also *Ashland Oil. Inc. v. Tucker*, 768 S.W.2d 595 (Mo. App. E.D. 1989) (knowledge of territory, products, competition, customers and suppliers is protectable). Special training and technical education, standing alone, are not protectable interests. *Osage Glass*, 693 S.W.2d at 74.
4. In order to be enforceable a covenant restraining an employee must not only be legally valid but also reasonable as to the employer, the employee, and the public. Reasonableness is determined by the limitations on both time and area contained in the agreement. The test applied is "whether the area in which the restriction is to be enforced is larger than reasonably necessary for the protection of the covenantee." Application of this test requires "a thorough consideration of all surrounding circumstances, including the subject matter of the contract, the purpose to be served, the situation of the parties, the extent of the restraint, and the specialization of the business." . . . The burden of proving the reasonableness of the restriction is on the party claiming its benefit. *Reed, Roberts Associates, Inc. v. Bailenson*, 537 S.W.2d 238, 241-42 (Mo. App. 1976) (citations omitted).
5. If a covenant is overbroad, it can be modified and enforced to the extent it is reasonable. *Easy Returns Midwest, Inc.*, 964 S.W.2d at 453 (dicta); *Orchard Container*, 601 S.W.2d at 304; *R.E. Harrington, Inc. v. Frick*, 428 S.W.2d 945, 951 (Mo. App. 1968).
6. "The ordinary rules of contractual construction and enforcement are not necessarily applicable to non-compete agreements." *Morrow v. Hallmark Cards, Inc.*, 273 S.W.3d 15, 28 (Mo. App. W.D. 2008)

(citing *Continental Research Corp. v. Scholz*, 595 S.W.2d 396, 399 (Mo. App. E.D. 1980)).

## II. CONSIDERATION ISSUES

### A. Adequate Consideration

1. When a non-compete is ancillary to an at-will employment contract, continued employment constitutes sufficient consideration. *Nail Boutique, Inc., v. Church*, 758 S.W.2d 206, 210 (Mo. App. S.D. 1988); *Computer Sales Int'l, Inc. v. Collins*, 723 S.W.2d 450 (Mo. App. E.D. 1986); *Bailenson*, 537 S.W.2d at 241.

### B. Inadequate Consideration

1. *Sturgis Equipment Co., Inc. v. Falcon Indus. Sales Co.*, 930 S.W.2d 14 (Mo. App. E.D. 1996) (refusing to enforce non-compete in buy-sell stock agreement between employer and employee due to lack of consideration).

### C. Consideration Generally

1. Noting in dicta that “it would be more accurate to say that the justification for the covenant (the ‘consideration’) was not the continued employment *per se*, but rather the employer’s allowing the employee (by virtue of the employment) to have *continued* access to the protectable assets and relationships. Thus, it is, we suggest, merely a reductionism, and not precisely accurate, to say that the ‘consideration’ was ‘continued employment.’” *Morrow*, 273 S.W.2d at 28-29 (emphasis added).

## III. PARAMETERS OF THE GOVERNING STATUTE AND THE “REASONABLENESS TEST” AS APPLICABLE

### A. Non-competes Ancillary to an Employment Agreement

1. Held Enforceable

*Naegele v. Biomedical Sys. Corp.*, 272 S.W.3d 385, 389 (Mo. App. E.D. 2008) (upholding enforcement of non-compete/non-solicitation agreement and finding enforcing employer had protectable interest in preexisting customer contacts previously developed by employee who was subject to non-compete);

*Healthcare Servs. of the Ozarks, Inc.*, 198 S.W.3d at 609-10 finding non-competes were enforceable against former employees in 100

mile geographic territory over two years where employer “had a protectable interest in its patient base”);

*Bratten*, 162 S.W.3d at 49-52 (Mo. App. W.D. 2005) (upholding enforcement of covenant barring former employee from dealing with employer’s customers but finding covenant barring employee from engaging in attending physician statement and record business for two years after termination was too broad);

*Alltype Fire Protection Co. v. Mayfield*, 88 S.W.3d 120 (Mo. App. E.D. 2002) (covenant not to compete preventing former employee from selling, inspecting, or servicing fire prevention devices and equipment for two years and within 100 miles of the location of the employer’s business offices, upheld);

*Silvers, Asher, Sher, & McLaren, M.D.s Neurology, P.C. v. Batchu*, 16 S.W.3d 340, 343 (Mo. App. W.D. 2000) (covenant not to compete preventing former employee from performing any medical services or engaging in the practice of neurology for two years and within 75 miles of the location of the employer’s business office, upheld);

*Bailenson*, 537 S.W.2d at 241-242 (three-year, three-state limitation reasonable under circumstances);

*House of Tools & Engineering, Inc. v. Price*, 504 S.W.2d 157, 159 (Mo. App. 1973) (three-year, two-state restriction upheld); and

*Gold v. Holiday Rent-A-Car Int’l, Inc.*, 627 F. Supp. 280 (W.D. Mo. 1985) (75-mile restraint on opening of competing rental car agency upheld).

2. Held Unenforceable or Modified

*Payroll Advance*, 270 S.W.3d at 433-438 (affirming trial court’s finding that 50 mile, 2 year non-compete in payday loan industry was unreasonable “under the facts and circumstances of the particular industry, agreement, and geographic location here involved” and refusing to modify covenant because issue was never raised by suing employer in trial court);

*JTL Consulting, L.L.C. v. Shanahan*, 190 S.W.3d 389, 396-399 (Mo. App. E.D. 2006) (holding plaintiffs did not have a protectable interest in its members’ customer contacts and thus could not enforce non-solicitation clause);

*Easy Returns Midwest, Inc. v. Schultz*, 964 S.W.2d 450, 453-54 (Mo. App. E.D. 1998) (finding that employer failed to show that the former employee/salesperson had contacts of a kind enabling him to influence customers in any part of the geographic area to support a 30-month 24-state covenant not to compete);

*West Group Broadcasting, Ltd. v. Bell*, 942 S.W.2d 934 (Mo. App. S.D. 1997) (covenant unenforceable due to lack of protectable interest – “The only things that Bell took with her and used when she went from KXDG to KSYN were her aptitude, skill, mental ability, and the voice with which she was born.”);

*Mid-States Paint & Chemical Co. v. Herr*, 746 S.W.2d 613 (Mo. App. E.D. 1988) (350-mile restraint on industrial coatings salesman reduced to 125 miles);

*Mo-Kan Cent. Recovery Co. v. Hedenkamp*, 671 S.W.2d 396, 400-401 (Mo. App. W.D. 1984) (refusing to enforce a non-compete where the evidence that a bidding structure and repossession techniques were trade secrets was too general and conclusory);

*Frick*, 428 S.W.2d at 945 (covenant preventing competition in any state the former employer was doing business enforced as to three-state area in which the employer, a specialized corporation with a limited clientele, had over 1,900 customers); and

*Sigma Chemical Co. v. Harris*, 794 F.2d 371 (8th Cir. 1986) (two-year non-compete covenant lacking geographic limitation enforced so as to prohibit employment with a known competitor).

## **B. Non-competes Incidental to the Sale of a Business**

*Horizon Memorial Group, L.L.C. v. Bailey*, \_\_\_S.W.3d\_\_\_, 2009 WL 166973 (Mo. App. W.D. January 27, 2009) (affirming enforcement of a ten-year, 30 mile radius non-compete against seller of funeral business following seller’s breach of non-compete terms);

*Migar Enterprises., Inc. v. DeMent*, 817 S.W.2d 911, 912 (Mo. App. W.D. 1990) (five year non-compete in sale of survey business upheld);

*Champion Sports Center, Inc. v. Peters*, 763 S.W.2d 367 (Mo. App. E.D. 1989) (covenant not to compete in retail sale of sporting goods, equipment and trophies for 8 years within three counties upheld);

*Schnucks Twenty-Five, Inc. v. Bettendorf*, 595 S.W.2d 279 (Mo. App. 1979) (covenant not to engage in retail food business for ten years within 200-mile radius of the City of St. Louis found enforceable);

*Kreger Glass Co. v. Kreger*, 49 S.W.2d 260 (Mo. App. 1932) (seller's covenant not to compete within 25 miles of city for as long as the purchaser remained in business in same territory upheld);

*Angelica Jacket Co. v. Angelica*, 98 S.W. 805 (Mo. App. 1906) (seller's covenant not to engage in the manufacture of jackets and aprons in approximately 33 states for a nine-year period found enforceable).

#### IV. GENERAL COMMENTS

##### A. Specific Issues

1. Is a non-compete covenant enforceable if the employee is discharged? It depends. See *McKnight v. Midwest Eye Institute of Kansas City, Inc.*, 799 S.W.2d 909, 917 (Mo. App. W.D. 1990); *Am. Nat'l Ins. Co. v. Coe*, 657 F.Supp. 718, 723 (E.D. Mo. 1986); *Showe-Time Video Rentals, Inc. v. Douglas*, 727 S.W.2d 426 (Mo. App. S.D. 1987); *Adrian N. Baker & Co. v. Demartino*, 733 S.W.2d 14, 18 (Mo. App. 1987).
2. Are attorneys' fees recoverable? Generally not (except perhaps by the old employer on a tortious interference claim against the new employer or by the employee on the injunction bond if the TRO or preliminary injunction is dissolved). See, e.g., *Payroll Advance*, 270 S.W.3d at 434 (reversing award of attorneys' fees where employer seeking to enforce non-compete failed to show actual or threatened breach of specific terms of non-compete); *Collins & Hermann-Welsbasch & Associates Div., Inc. v. St. Louis County*, 684 S.W.2d 324, 326 (Mo. 1985) (injunction bond); see also *Dent Wizard Int'l Corp. v. Puricelli*, 976 S.W.2d 582 (Mo. App. E.D. 1998) (per curiam order; refusing to overturn on appeal that part of judgment requiring each party to pay its own attorneys' fees).
3. Will employer's breach of the employment agreement relieve the employee of his obligation not to compete? Yes, if the prior breach is material (unless the employee waives or is estopped from asserting the breach). *McKnight*, 799 S.W.2d at 914-16; *Adrian N. Baker*, 733 S.W.2d at 17; *Ballesteros v. Johnson*, 812 S.W.2d 217, 222 (Mo. App. E.D. 1991).

4. Will a choice of law provision in contract be followed? Generally, yes. See *Ozark Appraisal Service, Inc. v. Neale*, 67 S.W.3d 759, 764 (Mo. App. 2002) (Missouri courts generally will enforce a choice of law provision, as long as application of the chosen law would not violate a fundamental public policy of Missouri); *Consolidated Financial Investments, Inc. v. Manion*, 948 S.W.2d 222, 224 (Mo. App. E.D. 1997) (not a covenant case); see also *Baxter Int'l. Inc. v. Morris*, 976 F.2d 1189, 1195-1197 (8th Cir. Oct. 9, 1992) (analyzing contractual choice of law provision under Section 187 of the Restatement (Second) of Conflict of Laws (1971)). But see *Shanahan*, 190 S.W.3d at 396 (Mo. App. E.D. 2006) (noting even with Delaware choice of law provision, parties can waive choice of law by their conduct, in this case choosing to rely on Missouri law notwithstanding contract language).
  
5. Are punitive damages ever available against party violating or causing a breach of a non-compete? Yes. See, e.g., *Bailey*, 2009 WL 166973 (Mo. App. W.D. January 27, 2009) (reversing JNOV and finding plaintiff buyer of funeral home business offered sufficient evidence of "evil motive" to justify jury's \$100,000 punitive damages award against competing funeral home business for causing breach of non-compete by seller of funeral home business who went to work for competitor business).

## B. Miscellaneous

Non-competes may be ancillary to an independent contractor relationship. See *Renal Treatment Centers-Missouri, Inc. v. Braxton*, 945 S.W.2d 557, 563 (Mo. App. E.D. 1997).

A forfeiture of benefits provision may not be treated as a restraint of trade and therefore may not be subject to the same type of analysis. See *Grebing v. First Nat'l Bank of Cape Girardeau*, 613 S.W.2d 872, 875-76 (Mo. App. E.D. 1981) (forfeiture provision in the bank/employer's non-contributory profit-sharing pension plan did not constitute a restraint of trade and thus did not require the court to determine whether it was reasonable).

Trade secrets defined: See *Nat'l Rejectors, Inc. v. Trieman*, 409 S.W.2d 1, 18-19 (Mo. 1966) (quoting Restatement of Torts § 757).

Noteworthy articles and/or publications: William M. Corrigan Jr. & Michael B. Kass, *Non-compete Agreements and Unfair Competition-An Updated Overview*, 62 J. Mo. Bar 81-90 (2006); Comment, *Covenants Not to Compete - Enforceability Under Missouri Law*, 41 Mo. L. Rev. 37 (1976).

Noteworthy case summarizing scope of permissible/impermissible restraints: *See Herrington v. Hall*, 624 S.W.2d 148 (Mo. App. W.D. 1981).

## MONTANA

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## MONTANA

### I. STATEMENT OF THE LAW

Montana Code Annotated Section 28-2-703 (“Section 703”) provides: “Any contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than is provided for by 28-2-704 or 282-2-705, is to that extent void.” Express exceptions to this rule exist for the following business transactions:

- A. Sale of goodwill of a business where the buyer continues to carry on a like business and the noncompete restricts the seller from carrying on a similar business in the following geographic territories:
  - 1. The city or county where the principal office is located;
  - 2. A county or city in any county adjacent to the county in which the principal office of the business is located; and
  - 3. Any combination of the above.
- B. Dissolution of partnership where, upon dissolution the partners agree that one or more of them may not carry on a similar business within the areas provided in the sale of goodwill exception.

While Montana statutes, with limited exceptions, provide that covenants not to compete are generally void and unenforceable, the courts will nonetheless enforce reasonable noncompete covenants. *Montana Mountain Prods. v. Curl*, 112 P.3d 979, 980 (2005) (“In addition to these two statutory exceptions to the bar on contracts in restraint of trade, this Court has held that only restraints on trade that are unreasonable are void.”).

### II. PARAMETERS OF THE “REASONABLENESS” TEST

“[T]he same standard of reasonableness applies to a restrictive covenant regardless of whether it is found within a trade contract or an employment contract.” *State Med. Oxygen & Supply v. American Med. Oxygen Co.*, 782 P.2d 1272, 1276 (1989); see also *Dobbins v. DeGuire & Tucker, P.C. v. Rutherford*, 708 P.2d 577, 580 (1985) (concluding similar principles apply to restrictive covenants in trade and employment context). A noncompete covenant is reasonable and enforceable where the restriction “is (1) limited in operation as to either time or place, (2) based upon some good consideration, and (3) affords some reasonable protection for and [does] not impose an unreasonable burden upon the employer, the employee, or the public.” *State Med. Oxygen*, 782 P.2d

at 1275.

A reasonable covenant “should afford only a fair protection to the interests of the party in whose favor it is made, and must not be so large in its operation as to interfere with the interest of the public.” *Dobbins*, 708 P.2d at 580 (internal quotations and citations omitted). A covenant purporting to restrain an employee from engaging in his profession or trade is unreasonable and an unlawful restraint of trade. *Montana Mountain Prods.*, 112 P.3d at 982.

#### **A. Reasonable covenants**

1. *Daniels v. Thomas, Dean & Hoskins*, 804 P.2d 359, 370-72 (Mont. 1990): Restriction in share repurchase agreement requiring employee to accept reduced repurchase price for shares in the event he competed with former employer after termination was reasonable noncompete covenant:
  - Reasonably limited temporally: Share repurchase provision requiring payment to be made 120 days after audit following termination date, but no sooner than 240 days after termination, interpreted as temporal restriction on noncompete covenant;
  - Based on good consideration where employee-shareholder had access to the company’s confidential information during employment and employer was required to repurchase shares from employee upon termination; and
  - Afforded reasonable protection and did not impose an unreasonable burden where the covenant operated to deter, but did not prohibit, competition by imposing reduced calculation of share repurchase price in the event of post-termination competition.
  - *But see, id.* at 375-76 (dissenting op., J. Sheeny) (refusing to read provision regarding timing for payment on share repurchase as creating a temporal restriction on noncompete restriction and finding covenant should have been rejected as unreasonable and unenforceable).
2. *Dobbins*, 708 P.2d 577: Covenant requiring employee to pay fee to former employer for each of the former employer’s clients from which the employee obtained business for twelve months post-termination was not, on its face, unreasonable. Likely because the issue was not raised, the court did not distinguish between clients

the employee had solicited and those whose business was obtained through other means.

## B. Unreasonable covenants

1. *State Med. Oxygen*, 782 P.2d at 1273-75: Covenant not to disclose employer's trade secrets and customer and other business-related information (regardless of confidential or public nature of information) that lacked any territorial or temporal limits violated Section 703 and was unenforceable.
2. *Montana Mountain Prods.*, 112 P.3d at 982: Three-year noncompete that "outright prohibited [former employee] from practicing her trade within 250 miles of her former employer" was an unlawful restraint of trade.
3. *First Am. Ins. Agency v. Gould*, 661 P.2d 451, 454 (Mont. 1983): Ten-year, 25-mile radius noncompete unreasonable where employer failed to prove protectable interest in customer information restrictive covenant sought to protect.

## III. GENERAL COMMENTS

- A. Protectable interests:** Restrictive covenants are only enforceable to the extent reasonably necessary to protect the employer's legitimate interest. In determining whether to enforce the covenant, the court must balance the competing interests of the employer, the employee, and the public. *Dobbins*, 708 P.2d at 580. Legitimate interests include:
1. Customer information that is "confidential and not readily accessible to competitors." *First Am. Ins.*, 661 P. 2d at 454 (quoting and citing *Best Maid Dairy Farms v. Houchen*, 448 P.2d 158, 161 (1968)).
  2. The employer's goodwill and customer base. See, e.g., *Dobbins*, 708 P.2d. at 579-80.
- B.** Customer restrictions are valid if they do not constitute a direct restraint on the employee's right to engage in her trade or profession. *Dobbins*, 708 P.2d at 579-80 (finding provision that required employee to pay fee to former employer for each of the former employer's clients from which the employee obtained business for twelve months post-termination did not prohibit competition and was "not unreasonable on its face").
- C. Blue pencil/modification:** The permissibility of blue penciling noncompete covenants has not been decided in the employment context.

A Montana court did blue-pencil a 100-mile-radius restrictive covenant ancillary to a sale of business. *Dumont*, 822 P.2d 96 (Mont. 1991). The court found the covenant enforceable only to the extent it restricted competition in the county in which the sale occurred and the contiguous counties, even though the 100-mile radius purported to reach beyond this statutorily permitted region. *Id.* at 98. “Under this ‘blue pencil approach’ the District court in the instant case acted correctly in limiting the noncompetition covenant to the contiguous counties as required by [Section 704].” *Id.* (citing *Treasure Chemical, Inc. v. Team Lab. Chemical Corp.*, 609 P.2d 285 (Mont. 1980)).

- D. Consideration:** A covenant signed at the inception of employment is supported by sufficient consideration. *Access Organics, Inc. v. Hernandez*, 175 P.3d 889, 903 (Mont. 2008). However, once employed, continued employment alone will not support an “after-thought” noncompete. *Id.* at 903-04. Rather, for an “after-thought” covenant not to compete to be enforceable, the employer must provide independent consideration to support the restriction. *Id.* at 903. Such independent consideration may include (but is not necessarily limited to) a salary increase or promotion, access to trade secrets or other confidential information, or a guaranteed minimum term of employment to an otherwise “at will” employee. *Id.* at 903-04.
- E. Construction:** “Contracts not to compete are by their nature in restraint of trade and are not favorably regarded by the courts. In interpreting or construing contracts which impose restrictions on the right of a party to engage in a business or occupation, the court is governed by a strict rule of construction. The agreement will not be extended by implication, and it will be construed in favor of rather than against the interest of the covenantor.” *Dumont*, 822 P.2d at 98 (quoting and citing with approval 54 Am. Jur. 2d Monopolies Etc., § 521).
- F. Will a choice of law provision in a contract be followed?**

Likely. The issue has not yet been addressed in a restrictive covenant case, but Montana courts typically follow the Restatement (Second) of Conflict of Laws and apply the law of the chosen state unless (a) it has no substantial relationship with the parties or the transaction or there is no other reasonable basis for the choice, or (b) application of the chosen state’s law would be contrary to the fundamental public policy of the state whose law would have governed the contract absent the choice of law provision. *Van Gundy v. P.T. Freeport Indonesia*, 50 F. Supp. 2d 993, 996 (D. Mont. 1999) (applying Montana choice of law rules to employment contract); *Keystone, Inc. v. Triad Sys. Corp.*, 971 P.2d 1240, 1242 (Mont. 1998).

**G. Trade secrets defined: Mont. Code Ann. § 30-14-402(4).**

## NEBRASKA

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## NEBRASKA

### I. OVERVIEW OF THE LAW

#### A. Statutory Statement of the Law

Not applicable.

#### B. Judicial Statement of the Law

1. There are three general requirements relating to partial restraints of trade. First, is the restriction reasonable in the sense that it is not injurious to the public; second, is the restriction reasonable in the sense that it is no greater than is reasonably necessary to protect the employer in some legitimate interest; and, third, is the restriction reasonable in the sense that it is not unduly harsh and oppressive on the employee . . . . Satisfactory proof is required of the one seeking injunctive relief to establish the necessity for and the reasonableness of covenants restraining the inherent right to labor in cases when the restraint deals with the performance of personal services. *Securities Acceptance Corp. v. Brown*, 106 N.W.2d 456, 463-464 (Neb. 1960), *opinion clarified and rehearing denied*, 107 N.W.2d 450 (Neb. 1961). See also *Vlasin v. Len Johnson & Co.*, 455 N.W.2d 772, 775-76 (Neb. 1990); *Polly v. Ray D. Hilderman & Co.*, 407 N.W.2d 751, 754 (Neb. 1987); *Am. Security Services, Inc. v. Vodra*, 385 N.W.2d 73, 78 (Neb. 1986); *Boisen v. Petersen Flying Service, Inc.*, 383 N.W.2d 29, 33 (Neb. 1986); *Brewer v. Tracy*, 253 N.W.2d 319, 321 (Neb. 1977); *Diamond Match Div. of Diamond Int'l Corp. v. Bernstein*, 243 N.W.2d 764, 766 (Neb. 1976).
2. Protectable interests include the sale of good will, customer contacts, trade secrets and other confidential information. *Boisen*, 383 N.W.2d at 33; *Brockley v. Lozier Corp.*, 488 N.W.2d 556, 564 (Neb. 1992). Compare *Moore v. Eggers Consulting Co., Inc.*, 562 N.W.2d 534 (Neb. 1997) (Former employer not entitled to protection against ordinary competition by former employee).
3. In order to “distinguish between ‘ordinary competition’ and ‘unfair competition,’ this court has consistently focused on the employee’s opportunity to appropriate the employer’s goodwill by initiating personal contacts with the employers’ customers.” *Mertz v. Pharmacists Mut. Ins. Co.*, 625 N.W.2d 197, 204 (Neb. 2001). Specifically, “Where an employee has substantial personal contact with the employer’s customers, develops good will with such customers, and siphons away the goodwill under circumstances where the goodwill properly belongs to the employer, the

employee's resultant competition is unfair, and the employer has a legitimate need for protection against the employee's competition." *Id.*

4. "As a general rule, 'a covenant not to compete in an employment contract 'may be valid only if it restricts the former employee from working for or soliciting the former employer's clients or accounts *with whom the former employee actually did business and has personal contact.*'" *Id.* at 204-205 (emphasis added) (citing *Professional Business Servs. v. Rosno*, 589 N.W.2d at 832).
5. It is lawful for the [seller of a business] to restrict his own freedom of trade only so far as it is necessary to protect the buyer in the enjoyment of good will for which he pays. The restraint on his own freedom must be reasonable in character and in extent of space and time. . . . Courts have generally been more willing to uphold promises to refrain from competition made in connection with sales of [businesses] than those made in connection with contracts of employment. *Chambers-Dobson, Inc. v. Squier*, 472 N.W.2d 391, 397 (Neb. 1991) (citations omitted).

## **II. CONSIDERATION ISSUES**

### **A. Consideration Generally**

1. Continued employment appears to be sufficient consideration for a non-compete agreement. See *Brown*, 106 N.W.2d at 462-63 (dictum).

## **III. PARAMETERS OF THE GOVERNING STATUTE AND THE "REASONABLENESS TEST" AS APPLICABLE**

### **A. Non-competes Ancillary to an Employment Agreement**

1. Held Enforceable

*C & L Indus., Inc. v. Kiviranta*, 698 N.W.2d 240 (Neb. 2005) (reversing trial court and finding covenant not to compete was not overly broad and was properly limited in scope to be enforceable because it was limited to preventing competition with clients or customers of C & L by former employee);

*Vodra*, 385 N.W.2d at 80 (three-year restriction barring employee from soliciting or dealing with former employer's customers whom he had serviced, upheld); and

*Farmers Underwriters Ass'n v. Eckel*, 177 N.W.2d 274 (Neb. 1970) (one-year restriction against soliciting former employer's customers upheld).

2. Held Unenforceable or Modified

*Controlled Rain, Inc. v. Sanders*, 2006 WL 1222772 (Neb. App. May 9, 2006) (affirming trial court's finding that non-compete was unenforceable because Nebraska case law required two paragraphs of non-compete be treated as integrated and non-severable despite severability clause in agreement);

*Mertz*, 625 N.W.2d at 205 (affirming trial court's finding that covenant not to compete was broader than reasonably necessary to protect employer's legitimate interest in customer goodwill because covenant prohibited solicitation of all pharmacies in Nebraska and not just those solicited by former employee);

*Brockley*, 488 N.W.2d at 564 (four-year restriction held unreasonable);

*Vlassin v. Len Johnson & Co.*, 455 N.W.2d 772, 776 (Neb. 1990) (reversing trial court and finding three year non-compete with 50 mile radius restriction in insurance business to be unreasonable and therefore unenforceable);

*Polly*, 407 N.W.2d at 755 (Neb. 1987) (restriction was overly broad where it prevented employee from being employed by former employer's clients including those whom employee had never contacted);

*Phillip G. Johnson & Co. v. Salmen*, 317 N.W.2d 900, 904 (Neb. 1982) (covenant unreasonable where it prohibited accountant from soliciting former employer's former clients, as well as current clients whom accountant had never serviced);

*Nat'l Farmers Union Serv. Corp. v. Edwards*, 369 N.W.2d 76, 80 (Neb. 1985) (25-mile radius was overly broad where it comprised excessive populous outside of former employee's territory);

*Brewer*, 253 N.W.2d at 319 (5-year, 15-mile restriction unreasonable);

*Brown*, 106 N.W.2d at 467 (18-month restriction held unreasonable); and

*DCS Sanitation Management v. Castillo*, 435 F.3d 892 (8th Cir. 2006) (affirming judgment for former employees of DCS and finding one year non-compete preventing contract cleaning services within 100 miles of DCS was overly broad and unenforceable under Nebraska law).

## **B. Non-competes Incidental to the Sale of a Business**

*Gary's Implement, Inc. v. Bridgeport Tractor Parts, Inc.*, 702 N.W.2d 355 (Neb. 2005) (reversing jury verdict in favor of seller of business claiming breach of contract for failure to make annual payments and remanding due to errors to allow, among other things, buyer to prosecute counterclaim that seller breached non-compete in connection with sale of business);

*H & R Block Tax Services, Inc. v. Circle A Enterprises, Inc.*, 693 N.W.2d 548 (Neb. 2005) (reversing trial court finding non-compete unenforceable and holding franchise agreement was analogous to sale of business and that one-year duration of covenant not to compete and geographic limitation of 45 miles from city where franchise was located were reasonable);

*Squier*, 472 N.W.2d at 391 (upholding two-year restraint prohibiting solicitation of former customers); and

*D.W. Trowbridge Ford, Inc. v. Galyen*, 262 N.W.2d 442 (Neb. 1978) (fifteen-year, one-county restriction was reasonable under the circumstances).

## **IV. GENERAL COMMENTS**

### **A. Specific Issues**

1. If a noncompetition covenant is overbroad, it is void. Nebraska courts will *not* equitably modify a restrictive covenant. *Terry D. Whitten, D.D.S., P.C. v. Malcom*, 541 N.W.2d 45, 47 (Neb. 1995) (no reformation regardless of modifiability clause in agreement); *Vlassin*, 455 N.W.2d at 776; *Brockley*, 488 N.W.2d at 564; *Polly*, 407 N.W.2d at 755.
2. A forfeiture of benefits provision is treated as a restraint of trade and thus is subject to the same analysis as other noncompetition covenants. *Brockley*, 488 N.W.2d at 563.

3. Whether a choice of law provision in a contract will be followed depends on whether application of the selected law would be contrary to a fundamental policy of Nebraska. *Rain & Hail Ins. v. Casper*, 902 F.2d 699, 700 (8th Cir. 1990) (court, applying Nebraska law, refused to enforce a choice of law provision selecting Iowa law to govern a restrictive covenant to be enforced in Nebraska; court concluded that application of Iowa law, which permitted modification of an overbroad covenant, would have been contrary to a fundamental policy of Nebraska law, which did not permit such reformation).

## **B. Miscellaneous**

1. Trade secrets defined: See *Henkle & Joyce Hardware Co. v. Maco, Inc.*, 239 N.W.2d 772, 775 (Neb. 1976) (quoting from Restatement, Torts, section 757).
2. Noteworthy articles and or publications: The Legal Implications of Covenants Not to Compete in Veterinary Contracts, 71 Neb. L. Rev. 826 (1992); Dead or Alive? Territorial Restrictions in Covenants Not to Compete in Nebraska, 33 Creighton L. Rev. 175 (Dec. 1999).
3. Noteworthy cases summarizing scope of permissible/impermissible restraints. *Professional Business Services Co. v. Rosno*, 589 N.W.2d 826 (Neb. 1999), *aff'd*, 680 N.W.2d 176 (Neb. 2004); *Malcom*, 541 N.W.2d at 47; *Brockley*, 488 N.W.2d at 556; *Polly*, 407 N.W.2d at 751; *Boisen*, 383 N.W.2d at 29.

## NEVADA

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## NEVADA

### I. STATEMENT OF THE LAW

Nevada permits reasonable covenants not to compete by statute:

Nev. Rev. Stat. § 613.200. **Prevention of employment of person who has been discharged or who terminates employment unlawful; criminal and administrative penalties; exception.**

- A. Except as otherwise provided in this section, any person, association, company or corporation within this state, or any agent or officer on behalf of the person, association, company or corporation, who willfully does anything intended to prevent any person who for any cause left or was discharged from his or its employ from obtaining employment elsewhere in this state is guilty of a gross misdemeanor and shall be punished by a fine of not more than \$5,000.
- B. In addition to any other remedy or penalty, the Labor Commissioner may impose against each culpable party an administrative penalty of not more than \$5,000 for each such violation.
- C. If a fine or an administrative penalty is imposed pursuant to this section, the costs of the proceeding, including investigative costs and attorney's fees, may be recovered by the Labor Commissioner.
- D. The provisions of this section do not prohibit a person, association, company, corporation, agent or officer from negotiating, executing and enforcing an agreement with an employee of the person, association, company or corporation which, upon termination of the employment, prohibits the employee from:
  - 1. Pursuing a similar vocation in competition with or becoming employed by a competitor of the person, association, company or corporation; or
  - 2. Disclosing any trade secrets, business methods, lists of customers, secret formulas or processes or confidential information learned or obtained during the course of his employment with the person, association, company or corporation, if the agreement is supported by valuable consideration and is otherwise reasonable in its scope and duration.

However, an agreement not to compete with a former employer will be enforced only if the terms are "reasonable." *Camco, Inc. v. Baker*, 113

Nev. 512, 518, 936 P.2d 829, 830 (1997), *citing Hansen v. Edwards*, 83 Nev. 189, 191, 426 P.2d 792, 793 (1967).

## II. PARAMETERS OF THE “REASONABLENESS” TEST

### A. Ancillary to an employment contract:

A restraint is unreasonable if it is greater than is required for the protection of the person for whose benefit the restraint is imposed or imposes undue hardship upon the person restricted. *Hansen*, 83 Nev. at 191-192. The period of time during which the restraint is to last and the territory that is included are important factors to be considered in determining the reasonableness of the agreement. *Id.*

### B. Ancillary to the sale of a business:

Nev. Rev. Stat. § 589A.040(5)(b) allows a contract of sale to prohibit the seller of a business from competing with the purchaser of the business within a reasonable market area and for a reasonable period of time. Nev. Rev. Stat. § 589A.040(5)(b).

## III. GENERAL COMMENTS

**A. Protectable interests:** Customer contacts and goodwill are interests protectable by a covenant not to compete. *See Camco*, 113 Nev. at 520. Trade secrets are protected by Nevada’s Uniform Trade Secrets Act, Nev. Rev. Stat. §§ 600A.010 *et seq.*

**B. Scope of the restriction:** An orthopedic surgeon’s two year covenant, limited to the practice of general medicine only (and not orthopedic surgery also), in the geographic area serviced by a medical clinic, was held to be reasonable. *Ellis v. McDaniel*, 95 Nev. 455, 596 P.2d 222 (1979). A podiatrist’s one year limitation for the City of Reno was held to be reasonable. *Hansen, supra* (court imposed a one year limitation to covenant which had no temporal limitation). A five year covenant not to compete was held to be *per se* unreasonable and unenforceable. *Jones v. Deeter*, 112 Nev. 291, 913 P.2d 1272 (1996). A covenant not to compete which applied to areas “targeted” for corporate expansion, where there was no established customer base or goodwill in such areas, was held to be completely unreasonable and unenforceable. *Camco, supra*.

**C. Blue pencil/modification:** Although earlier Nevada cases “blue penciled” overly broad covenants not to compete to render them enforceable, more recent case law reveals that Nevada courts will not “blue pencil” overly broad covenants not to compete. *See, e.g., Camco, supra* (covenant not to compete which was unreasonable in territorial scope was

unenforceable as against public policy); *Deeter, supra* (five year restriction on competition held to impose too great a hardship and was therefore unenforceable).

- D. Consideration:** Continued at-will employment is valid consideration for a post-hire non-compete restriction. *Camco*, 113 Nev. 512. Accordingly, the inception of at-will employment will also likely constitute valid consideration for a non-compete restriction. *Id.* at 518 (there is “no substantive difference between the promise of employment upon hire and the promise of continued employment subsequent to ‘day one’”).
- E. Assignability:** Under Nevada law, absent an express assignment clause, a covenant not to compete is personal in nature and is unassignable, absent the employee’s express consent. *Traffic Control Services, Inc. v. United Rentals Northwest, Inc.*, 120 Nev. 168, 87 P.3d 1054 (2004). In addition, assignability clauses must be negotiated at arm’s length and supported by additional and separate consideration from that given in exchange for the covenant itself. *Id.* at 174-175.
- F. Choice of law:** Under Nevada law, parties can generally select the law that will govern the validity and effect of their contract, so long as the situs has a substantial relationship to the transaction and the agreement is not contrary to the public policy of Nevada. *Engel v. Ernst*, 102 Nev. 390, 395, 724 P.2d 215 (1986) (not a covenant not to compete case). In the absence of a choice of law provision, Nevada courts generally apply the law of the state with the “most significant relationship” to the contract and the parties. See, e.g., *Insurance Co. of N. Amer. V. Hilton Hotels U.S.A., Inc.*, 908 F. Supp. 809, 814 (D. Nev. 1995) (not a covenant not to compete case).
- G. Trade secret definition:** Nev. Rev. Stat. § 600A.030.
- H. Protection of confidential or trade secret information (absent a covenant not to compete)?** Yes. Nevada’s Uniform Trade Secrets Act, Nev. Rev. Stat. §§ 600A.010 *et seq.* prohibits actual or threatened misappropriation of trade secrets.

## **NEW HAMPSHIRE**

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## NEW HAMPSHIRE

### I. SUMMARY OF THE LAW

In order to be enforceable, a covenant restraining an employee must not only be legally valid and supported by adequate consideration but also reasonable with respect to the interests of the employer, employee and public. The reasonableness of the agreement depends on the particular circumstances. To determine the reasonableness of a restrictive covenant ancillary to an employment contract, New Hampshire courts employ a three-pronged test: (i) whether the restriction is greater than necessary to protect the legitimate interests of the employer; (ii) whether the restriction imposes an undue hardship upon the employee; and (iii) whether the restriction is injurious to the public interest. If any of these questions is answered in the affirmative, the restriction in question is unreasonable and unenforceable. New Hampshire courts adopt a principle of strict construction when they interpret covenants not to compete. The Supreme Court of New Hampshire has stated that “the law does not look with favor upon contracts in restraint of trade or competition. Such contracts are to be narrowly construed.” *Technical Aid Corp. v. Allen*, 134 N.H. 1, 8 (1991) (reaffirmed in *Merrimack Valley Wood Products, Inc. v. Near*, 152 N.H. 192, 197 (2005)).

However, restrictive covenants are valid and enforceable if the restraints are reasonable, given the particular circumstances of the case. *Merrimack Valley Wood Products, Inc. v. Near*, 152 N.H. 192, 197 (2005). A covenant’s reasonableness is a matter of law for courts to decide. *Concord Orthopaedics Prof. Assoc. v. Forbes*, 142 N.H. 440, 443 (1997).

*Moore v. Dover Veterinary Hospital*, 367 A.2d 1044 (N.H. 1976); *Technical Aid Corp. v. Allen*, 591 A.2d 262 (N.H. 1991); *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310 (N.H. 1979); see also *Dunfey Realty Co. v. Enwright*, 138 A.2d 80 (N.H. 1958); *Merrimack Valley Wood Products, Inc. v. Near*, 152 N.H. 192 (N.H. 2005).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. Reasonable: *Moore v. Dover Veterinary Hospital*, 367 A.2d 1044 (N.H. 1976) (5-year restriction on practicing veterinary medicine within 20 miles of defendant's hospital is reasonable); *Technical Aid Corp. v. Allen*, 591 A.2d 262 (N.H. 1991) (prohibition on employee's engagement in competitive activities while he remained employed with the employer valid; eighteen-month restriction on soliciting clients of former employer reasonable); *Emery v. Merrimack Valleywood Products, Inc.*, 701 F.2d 985 (1st Cir. 1983) (one-year

limitation on sale to clients of former employer found reasonable under New Hampshire law); *Concord Orthopaedics Professional Association v. Forbes*, 702 A.2d 1273 (N.H. 1997) (two-year, twenty-five mile restriction on physician upheld as reasonable but not applicable to new patients); *ACAS Acquisitions (Precitech) Inc. v. Hobert*, 2007 N.H. LEXIS 65 (two-year restriction against engaging in any line of business that represents at least 5% of employer's gross revenues upheld as reasonable).

2. Unreasonable: *Dunfey Realty Co. v. Enwright*, 138 A.2d 80 (1958) (three-year, two county restriction found unreasonable due to limited amount of employer's business in the specified geographic area); *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310 (N.H. 1979) (3-year restriction on contacting any customer, past or present, of the largest accounting firm in New Hampshire and Vermont is unreasonably broad); *Ferrofluidics Corp. v. Advanced Vacuum Components*, 968 F.2d 1463 (1st Cir. 1992) (five-year restraint unlimited as to geography held unreasonable as to time); *National Employment Service Corporation v. Olsten Staffing Service, Inc.*, 761 A.2d 401 (N.H. 2000) (covenant not to compete found contrary to public policy where workers were at-will light industrial laborers who were not in a position to appropriate the company's goodwill and were without access to sensitive information; 100-mile geographic limitation was greater than necessary to protect Technical Aid's legitimate interests); *Merrimack Valley Wood Products, Inc. v. Near*, 152 N.H. 192, 199 (2005) (covenant not to compete covering 1,200 customers "goes far beyond the [company's] sphere of customer goodwill, and was more restrictive than necessary to protect the [company's] legitimate interests," given that the company had no particular claim to the goodwill of roughly 95% of those 1,200 identified customers). *Technical Aid Corp. v. Allen*, 591 A.2d 262 (N.H. 1991) (eighteen month, 100-mile restriction on engaging in a business similar to employers held unenforceable).

## **B. Incidental to the sale of a business.**

1. Reasonable: *Gosselin v. Archibald*, 437 A.2d 302 (N.H. 1981) (five-year, fifteen mile non-competition agreement reasonable); Cf. *Bancroft & Rich v. Union Embossing Co.*, 57 A. 97 (N.H. 1903) (assignment of exclusive right to manufacture certain type of embossing machine held equivalent to sale of good will in business of manufacturing such machine; covenant not to make or sell such machines during the period for which any letters patent might be

granted or, if none were granted, for twenty years (unlimited as to space), held valid in view of the nature of the business and the limited number of customers); *Centorr Vacuum Indus., Inc. v. Lavoie*, 609 A.2d 1213, 1215 (N.H. 1992) (non-competition covenants ancillary to a sale of a business can be interpreted more liberally than employment non-competition agreements because parties bargain from more even strength and proceeds from sale of business insure covenantor will not face undue hardship) (reaffirmed in *Clarkeies Mkt., L.L.C. v. Estate of Kelley* (In re *Clarkeies Mkt., L.L.C.*), 2004 BNH 24 (Bankr. D.N.H. 2004)).

### III. GENERAL COMMENTS

- A. Physician non-competes:** (“The weight of authority . . . supports enforcement of reasonable covenants not to compete involving physicians.” In determining the reasonableness of such a covenant, the court will consider the time necessary to “obliterate in the minds of the public the association between the identity of the physician with his employer’s practice.”) *Concord Orthopaedics Professional Association v. Forbes*, 702 A.2d 1273 (N.H. 1997).
- B. Protectible interests:** sale of good will, trade secrets and other confidential information. *Allied Adjustment Service v. Henev*, 484 A.2d 1189 (N.H. 1984); *Dunfey Realty Co. v. Enwright*, 138 A.2d 80 (1958); customer contacts, *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310 (N.H. 1979); *Technical Aid*, 591 A.2d at 271-72; *National Employment Service Corporation v. Olsten Staffing Service, Inc.*, 761 A.2d 401 (N.H. 2000) (employer’s trade secrets which have been communicated to the employee during the course of employment; confidential information communicated by the employer to the employee, but not involving trade secrets, such as information on a unique business method; an employee’s special influence over the employer’s customers, obtained during the course of employment; contacts developed during the employment; and the employer business’s development of goodwill and a positive image. The mere cost associated with recruiting and hiring employees is not a legitimate interest protectible by a restrictive covenant in an employment contract.) When an employee holds a position involving client contact, it is natural that some of the goodwill emanating from the client is directed to the employee rather than to the employer, and the employer has a legitimate interest in preventing its employees from appropriating this goodwill to its detriment.” *ACAS Acquisitions (Precitech) Inc. v. Hobert*, 2007 N.H. LEXIS 65, \*14 (citing *Merrimack Valley Wood Products, Inc. v. Near*, 152 N.H. 192, 198 (2005)).

- C. **Covenant Reformation:** If covenant is overbroad, it can be reformed if the employer shows it acted in good faith in the execution of the employment contract. See *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310, 1313 (N.H. 1979); *Technical Aid*, 591 A.2d at 271-72; *Ferrofluidics*, 968 F.2d at 1469.
- D. **Consideration:** Continued employment is sufficient consideration for a non-competition agreement. See *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310, 1312 (N.H. 1979)
- E. **Attorneys Fees:** Attorneys fees are generally not recoverable and may be awarded only by virtue of statutory authorization, an agreement between the parties, or an established exception. See *Maguire v. Merrimack Mutual Ins. Co.*, 573 A.2d 451, 453 (1990). But see *Harkeem v. Adams*, 377 A.2d 617 (1977); *St. Germain v. Adams*, 377 A.2d 620, 623 (1977); *Kennan v. Fearon*, 543 A.2d 1379, 1383 (1988). Under the New Hampshire Uniform Trade Secrets Act, the court may award reasonable attorneys' fees to the prevailing party when a claim of misappropriation of trade secrets is made in bad faith, a motion to terminate an injunction is made or resisted in bad faith, or willful and malicious misappropriation exists. N.H. Rev. Stat. Ann. §350-B:4.
- F. **Choice of Law:** Choice of law provision in contract will be followed. *Allied Adjustment Service v. Henev*, 484 A.2d 1189, 1190 (N.H. 1984) (choice of law provisions will be honored if any significant relationship to the chosen jurisdiction exists); see also *Ferrofluidics v. Advanced Vacuum Components, Inc.*, 968 F.2d 1463, 1467-68 (1st Cir. 1992) (dictum).
- G. **Trade Secrets:** Trade secrets defined: Information that "derives independent economic value, actual or potential, from not being generally known to and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use" and concerning which the owner has made "reasonable" efforts to "maintain its secrecy." N.H. Rev. Stat. Ann. §350-B:1 (1989).
- H. **Indirect Competition:** Covenants that explicitly forbid "indirect" competition may be upheld. *Centorr*, 609 A.2d at 1215 (upholding covenant incidental to sale of a business that expressly prohibited indirect competition).
- I. **Breach by Employer:** Non-competition agreements may not be enforceable if the employer breaches its employment agreement. See *Genex Cooperative, Inc. v. Bujnevicie*, 2000 WL 1507319 (D.N.H. July 17, 2000) (refusing to enforce a non-competition agreement where employer significantly decreased employee's salary. Court found this unilateral and

material reduction in salary to be a material breach of the employment agreement and refused to enforce the non-competition agreement despite a provision in the agreement that stated the restrictive covenant shall remain in full force and effect upon the termination of the agreement by either party.)

- J. Noteworthy articles and/or publications:** Russell F. Hilliard and Michael D. Urban, Covenants Not to Compete: An Overview, 30 N.H.B.J. 227 (1989); R. Jason D'Cruz, Dealing With the Moveable Employee and Complying With Employment Laws, 683 PLI/Pat 71 (2002).
- K. Noteworthy cases summarizing scope of permissible/impermissible restraints:** *Technical Aid Corp. v. Allen*, 591.A.2d.262 (N.H. 1991); *Concord Orthopaedics Professional Association v. Forbes*, 702 A.2d 1273 (N.H. 1997); *Merrimack Valley Wood Products, Inc. v. Near*, 152 N.H. 192 (N.H. 2005).

## NEW JERSEY

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## NEW JERSEY

### I. JUDICIAL STATEMENT OF THE LAW

In *Solari [Industries, Inc. v. Malady*, 55 N.J. 571, 264 A.2d 53 (N.J. 1970)], we recently adopted the judicial rule that noncompetitive agreements may receive total or partial enforcement to the extent reasonable under the circumstances. However, we pointed out that while a seller's noncompetitive covenant designed to protect the good will of the business for the buyer is freely enforceable, an employee's covenant not to compete after the termination of his employment is not as freely enforceable because of well recognized countervailing policy considerations. Nonetheless an employee's covenant will be given effect if it is reasonable under all the circumstances of his particular case; it will generally be found to be reasonable if it 'simply protects the legitimate interests of the employer, imposes no undue hardship on the employee, and is not injurious to the public.' 55 N.J. at 576.

*Whitmyer Bros., Inc. v. Doyle*, 274 A.2d 577, 580-81 (N.J. 1971); see also *Maw v. Advanced Clinical Commc'ns, Inc.*, 846 A.2d 604, 608-09 (N.J. 2004) (explaining that the enforceability of noncompete agreements is determined under the "Solari/Whitmyer" test, and that "Solari/Whitmyer has now become an accepted part of the common law"); *Raven v. A. Klein & Co., Inc.*, 478 A.2d 1208, 1210 (N.J. Super. Ct. App. Div. 1984) ("[R]estrictive covenants will be enforced to the extent that they are reasonable as to time, area and scope of activity, necessary to protect a legitimate interest of the employer, not unduly burdensome upon the employee, and not injurious to the public interest." (citing *Solari*, 264 A.2d at 56)).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract

1. *A. Hollander & Son, Inc. v. Imperial Fur Blending Corp.*, 66 A.2d 319, 336 (N.J. 1949) (two-year, east of St. Louis, Missouri, noncompete covenant reasonable); *Irvington Varnish & Insulator Co. v. Van Norde*, 46 A.2d 201 (N.J. 1946) (two-year nationwide noncompete covenant may be enforceable); *A.T. Hudson & Co., Inc. v. Donovan*, 524 A.2d 412 (N.J. Super. Ct. App. Div. 1987) (two-year noncompete covenant restricted to former employer's customers was enforceable); *Hogan v. Bergen Brunswick Corp.*, 378 A.2d 1164 (N.J. Super. App. Div. 1977) (one-year, two-county restriction was reasonable); *Karlin v. Weinberg*, 372 A.2d 616 (N.J. Super. Ct. App. Div. 1977), *aff'd*, 390 A.2d 1161 (N.J. 1978) (five-year, ten-mile radius restriction on dermatologist was reasonable).

2. *Solari Indus., Inc. v. Malady*, 264 A.2d 53 (N.J. 1970) (court adopted rule that overly broad noncompetitive provisions are partially enforceable to the extent reasonable under the circumstances and applied the rule to limit a broad one-year noncompete covenant with no geographic limitation to the United States); *Mallman, Ross, Toyes & Shapiro v. Edelson*, 444 A.2d 75 (N.J. Super. Ct. Ch. Div. 1982) (covenant restricting accountant was enforced only to the extent that the accountant could not solicit his former employer's customers; he could, however, serve those customers that chose to go with him).
  
3. *Comprehensive Psychology System, P.C. v. Prince*, 867 A.2d 1187 (N.J. 2005) (two-year, ten-mile radius restriction on psychologist was barred by rules of Board of Psychological Examiners; analogy was drawn to rules applicable to attorneys and client/patient choice was prioritized); *Community Hospital Group, Inc. v. More*, 869 A.2d 884 (N.J. 2005) (thirty-mile restriction prohibiting neurosurgeon from engaging in any practice of medicine was unreasonable).
  - (a) Incidental to the sale of a business
    - i) *Heuer v. Rubin*, 62 A.2d 812, 814 (N.J. 1949) (court enforced covenant preventing sellers of fruit and vegetable business from engaging in a similar business within the city of Rahway, even though there was no time limitation; where the "space contained in the covenant is reasonable and proper there need be no limitation as to time"); *J.H. Renarde, Inc. v. Sims*, 711 A.2d 410, 413 (N.J. Super. Ct. Ch. Div. 1998) (restrictive covenants made in connection with the sale of a business are assignable without express language to that effect and pass as an incident of the sale even though not specifically assigned); *Coskey's Television & Radio Sales & Service, Inc. v. Foti*, 602 A.2d 789, 793 (N.J. Super. Ct. App. Div. 1992) (covenants not to compete ancillary to the purchase of a business are given far more latitude than those ancillary to employment contracts); *Artistic Porcelain Co. v. Boch*, 74 A. 680, 681 (N.J. Ch. 1909) (three and a half-year covenant is enforceable by injunction).
    - ii) *Trenton Potteries Co. v. Oliphant*, 43 A. 723 (N.J. 1899); *Bloomfield Baking Co. v. Maluvius*, 163 A. 441 (N.J. Ch. 1932) (60-block radius for three years enforceable).

- iii) *Jackson Hewitt, Inc. v. Childress*, 2008 WL 834386, \*7 (D. N.J. March 27, 2008) (restrictions contained in franchise agreements are analogous to those contained in a sale of business, thus they must be freely enforced).

### III. GENERAL COMMENTS

- A. Protectable interests: Customer relationships, trade secrets, and confidential information, as distinguished from matters which are generally known within the industry or community. *Whitmyer Bros., Inc. v. Doyle*, 274 A.2d 577, 581 (N.J. 1971); *A.T. Hudson & Co., Inc. v. Donovan*, 524 A.2d 412, 433 (N.J. Super. Ct. App. Div. 1987).
- B. If a covenant is overbroad, the court may modify or “blue pencil” it and enforce it as modified to the extent reasonable. *Karlin v. Weinberg*, 390 A.2d 1161, 1168 (N.J. 1978); *Solari Indus., Inc. v. Malady*, 264 A.2d 53,61 (N.J. 1970) ; See, e.g., *Richards Manufacturing Co. v. Thomas & Betts Corp.*, 2005 WL 2373413 (D.N.J. Sept. 27, 2005).
- C. Continued employment is sufficient consideration for a noncompetition agreement. See, e.g., *Hogan v. Bergen Brunswick Corp.*, 378 A.2d 1164, 1167 (N.J. Super. Ct. App. Div. 1977).
- D. A forfeiture of benefits provision apparently will be treated as a restraint of trade and therefore be subject to the same type of analysis. See, e.g., *Jacob v. Norris, McLaughlin & Marcus*, 607 A.2d 142, 148-49 (N.J. 1992) (attorney termination agreement which barred severance pay to attorneys if they rendered post-termination services to clients of the firm was void as violative of the public policy which gives the public the right to engage counsel of its own choosing); *Ellis v. Lionikis*, 394 A.2d 116, 119 (N.J. Super. Ct. App. Div. 1978) (restrictive covenant ancillary to benefits plan was subject to the same reasonableness standard as restrictive covenants ancillary to employment contracts); *Knollmeyer v. Rudco Indus., Inc.*, 381 A.2d 378, 380 (N.J. Super. Ct. App. Div. 1977) (forfeiture of benefits provision was valid as it only applied if defendant worked for plaintiff’s competitor). See also *Ingersoll-Rand Co. v. Ciavatta*, 542 A.2d 879 (N.J. 1988) (restrictive covenant purporting to give employer rights to inventions patented post-termination was subject to the same reasonableness standard as covenants not to compete).
- E. Is a noncompete covenant enforceable if the employee is discharged? Maybe. The *Hogan* court enforced the covenant against an employee who had been discharged, but the court did not address the issue of involuntary termination. *But see Karlin v. Weinberg*, 390 A.2d 1161, 1169

(N.J. 1978) (court suggests that if employer breaches employment contract, the covenant may be unenforceable).

- F.** Will employer's breach of employment agreement relieve the employee of his obligation not to compete? *Karlin* suggests it will. See 390 A.2d at 1169.
- G.** Can employer enforce an agreement when employer's former client, with whom employer does not currently have a relationship, hires employer's former employee? No. Enforcement of this type of agreement would improperly stifle competition. *Cost Reduction Solutions v. Durkin Group, LLC*, 2008 WL 3905679, at \*4 (N.J. Super. Ct. App. Div. Aug. 22, 2008).
- H.** Will a choice of law provision in a contract be followed? Yes, so long as it does not violate the public policy of New Jersey. See *Solari Indus., Inc. v. Malady*, 264 A.2d 53 (N.J. 1970); *Raven v. A. Klein & Co., Inc.*, 478 A.2d 1208, 1210 (N.J. Super. Ct. App. Div. 1984). See also *Shotwell v. Dairyman's League Coop. Ass'n, Inc.*, 37 A.2d 420, 422 (Warren County Ct. 1944).
- I.** Trade secrets defined: *Ingersoll-Rand Co. v. Chiavatta*, 542 A.2d 879, 893 (N.J. 1988); *Whitmyer Bros., Inc. v. Doyle*, 274 A.2d 577, 581 (N.J. 1971); *Raven v. A. Klein & Co., Inc.*, 478 A.2d 1208, 1210 (N.J. Super. Ct. App. Div. 1984).
- J.** Former employees may be enjoined from disclosing the trade secrets of their former employers, either by an express contract or through an implied contract by virtue of their confidential relationship. *Stone v. Goss*, 55 A. 736 (N.J. 1903). An employer may enjoin a former employee from using or disclosing a trade secret learned during the employment, even in the absence of an express agreement to that effect. *Sun Dial Corp. v. Rideout*, 108 A.2d 442, 446 (N.J. 1954).
- K.** A lawyer violates the New Jersey Rules of Professional Conduct by offering or making: (1) a partnership or employment agreement that restricts the rights of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement; or (2) an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a controversy between private parties. N.J. Rule Prof. Conduct 5.6 (1998).
- L.** Noteworthy cases summarizing scope of permissible/impermissible restraints: *Solari Indus., Inc. v. Malady*, 264 A.2d 53 (N.J. 1970); *Rubel & Jenson Corp. v. Rubel*, 203 A.2d 625, 629 (N.J. Super. Ct. App. Div. 1964).

## NEW MEXICO

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## NEW MEXICO

### I. STATUTORY AUTHORITY

New Mexico has no statute governing the enforceability or reasonableness of covenants not to compete.

### II. SUMMARY OF LAW

New Mexico courts have not decided many covenant not to compete cases. The Supreme Court authored the seminal case in 1939 and stated “[i]t is of course a well established rule that a naked agreement by one party not to engage in business in competition with another party is in contraventions of public policy and therefore void, unless such agreement and restriction be incidental to some general or principal transaction. That is, its main object must not be to stifle competition. *Nichols v. Anderson*, 92 P.2d 781, 783 (1939) (quoting *Gross, Kelly & Co. v. Bebo*, 145 P. 480 (N.M. 1914)). The court continued, stating that “[t]he principle is firmly established that contracts only in partial restraint of any particular trade or employment, if founded upon a sufficient consideration, are valid and enforceable, if the restraint be confined within limits which are no larger and wider than the protection of the party with whom the contract is made may reasonably require.” *Id.* (citation omitted).

More recently, a court noted that “[n]on-competition covenants are ordinarily enforceable as long as a court deems them reasonable.” *Insure New Mexico, L.L.C. v. McGonigle*, 995 P.2d 1053 (N.M. App. 2000) citing *Bowen v. Carlsbad Ins. & Real Estate, Inc.*, 724 P.2d 223, 225-26 (1986).

### III. ELEMENTS OF ENFORCEABILITY

#### A. Employer’s Protectable Interest

An employer’s protectable interest include trade secrets such as goodwill and the employer’s relationship with its customers. See *Lovelace Clinic v. Murphy*, 417 P.2d 450, 453 (1966); *Manuel Lujan Ins. v. Jordan*, 673 P.2d 1306 (1983); *Nichols v. Anderson*, 92 P.2d 781, 783 (1939).

#### B. Reasonableness Requirements

The only requirement for enforcing a covenant not to compete in New Mexico is that the length of time and geographic restriction must be no greater than that needed to protect the employer’s legitimate interests. See *Nichols v. Anderson*, 92 P.2d 781, 783 (1939) (court upheld the covenant not to compete that prohibited employee from directly or indirectly soliciting, calling for, or delivering articles to be cleaned, pressed or dyed or laundered in the Las Vegas or any other area where the

employee served the employer for one year after termination of employment was enforceable); *Manuel Lujan Insurance, Inc. v. Jordan*, 673 P.2d 1306 (1983) (the court upheld a 2-year non-compete agreement); *Lovelace Clinic v. Murphy*, 417 P.2d 450 (N.M. 1966) (the court held that a covenant which prohibited a doctor from practicing medicine in one county for three years was enforceable. The court noted that “[t]here is no doubt that this type of covenant tends to some extent to eliminate or restrict competition, and in many instances may operate as some compulsion on the part of the employee to remain in the employ of the employer. These are usually the main purposes of such covenants, and these are legitimate purposes, so long as the restrictions are reasonable. The court commented that “[i]n determining reasonableness, courts consider such factors as the nature of the business, its location, the parties involved, the purchase price, and the main object of the restriction).

### **C. Consideration**

New Mexico courts have not directly addressed what consideration is necessary for a covenant not to compete to be enforceable. However, the courts have enforced covenants not to compete entered into at the inception of the employment relationship and after the inception of the employment relationship. *Manuel Lujan Ins. v. Jordan*, 673 P.2d 1306 (1983); *Nichols v. Anderson*, 92 P.2d 781, 783 (1939).

## **IV. GENERAL COMMENTS**

### **A. Forfeiture Provisions**

A forfeiture of benefits provision apparently will not be treated as a restraint of trade and thus not be subject to the same analysis as other noncompetition covenants. *Swift v. Shop Rite Food Stores, Inc.*, 489 P.2d 881 (N.M. 1971). In *Swift*, the court upheld the validity of a forfeiture provision contained in an employer’s profit-sharing plan. The *Swift* court’s decision apparently is grounded on the fact that the forfeiture provision therein did not (1) provide the former employer the right to enjoin the former employee from being employed by a competing business or (2) make the former employee civilly liable to the employer for any other breach of covenant. This type of reasoning indicates that the New Mexico Supreme Court does not consider a forfeiture provision to be a restraint of trade.

### **B. Enforceability if Employer Terminates Employee**

One court determined that an employee would not be bound by covenant

not to compete when the employer terminated the employee without cause and the agreement specifically provided that the employee would not be bound in such a circumstance. *Danzer v. Professional Insurors*, 679 P.2d 1276, 1280-81.

**C. Choice of Law Provisions**

New Mexico courts have not directly addressed choice of law provisions in the covenant not to compete context. In addition, New Mexico has not expressly adopted Sections 186-88 of the Restatement (Second) of Conflict of Laws. Therefore, a court would likely weigh the public policy interest in enforcing the covenant in New Mexico versus the enforceability of the covenant in the chosen state.

**D. Sale of Business**

New Mexico courts are much more likely to enforce a restrictive covenant in a sale of business context than in an employment context. *Sonntag v. Shaw*, 22 P.3d 1188 (N.M. 2001).

**E. Attorney's Fees**

New Mexico courts have not specifically addressed whether attorney's fees are recoverable in a covenant not to compete case. In New Mexico, attorney's fees are not recoverable unless there is statutory authority or a rule of a court. *Hiatt v. Keil*, 738 P.2d 121, 122 (N.M. 1987). Therefore, it is unlikely that attorney's fees are recoverable in a covenant not to compete case.

## NEW YORK

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## NEW YORK

### I. SUMMARY OF THE LAW

“At one time, a covenant not to compete . . . was regarded with high disfavor by the courts and denounced as being ‘against the benefit of the commonwealth’ . . . It later became evident, however, that there were situations in which it was not only desirable but essential that such covenants not to compete be enforced.

“Where, for instance, there is a sale of a business, involving as it does the transfer of its good will as a going concern, the courts will enforce an incidental covenant by the seller not to compete with the buyer after the sale . . . The sole limitation on the enforceability of such a restrictive covenant is that the restraint imposed be ‘reasonable,’ that is, not more extensive, in terms of time and space, than is reasonably necessary to the buyer for the protection of his legitimate interest in the employment of the assets lost . . .

“Also enforceable is a covenant given by an employee that he will not compete with his employer when he quits his employ, and the general limitation of ‘reasonableness,’ to which we have just referred, applies equally to such a covenant . . . However, . . . the courts have generally displayed a much stricter attitude with respect to covenants of this type . . . Thus, a covenant by which an employee simply agrees, as a condition of his employment, not to compete with his employer after they have severed relations is not only subject to the overriding limitation of ‘reasonableness’ but is enforced only to the extent necessary to prevent the employee’s use or disclosure of his former employer’s trade secrets, processes, or formulae . . . or his solicitation of, or disclosure of any information concerning, the other’s customers . . . . If, however, the employee’s services are deemed ‘special, unique or extraordinary,’ then, the covenant may be enforced by injunctive relief, if ‘reasonable,’ even though the employment did not involve the possession of trade secrets or confidential customer lists.”

*Purchasing Assocs., Inc. v. Weitz*, 196 N.E.2d 245, 247-48, 245 (N.Y. 1963). See also *AM Media Communications Group v. Kilgallen*, 261 F.Supp.2d 258 (S.D.N.Y. 2003) (the Second Circuit disfavors restrictive covenants in the employment context, enforcing them only to the extent they are reasonable and necessary to protect valid interests); *BDO Seidman v. Hirshberg*, 712 N.E.2d 1220, 1223 (N.Y. 1999) (New York courts will enforce a restrictive covenant “only to the extent that it is reasonable in time and area, necessary to protect the employer’s legitimate interests, not harmful to the general public and not unreasonably burdensome to the employee”).

“The modern, prevailing common-law standard of reasonableness for employee agreements not to compete applies a three-pronged test. A restraint is reasonable only if it: (1) is *no greater* than is required for the protection of the

*legitimate interest* of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public. A violation of any prong renders the covenant invalid.” *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388-89, 690 N.Y.S.2d 854, 712 N.E.2d 1220 (1999).

A covenant will be rejected as overly broad if it seeks to bar the employee from soliciting or providing services to clients with whom the employee never acquired a relationship through his or her employment or if the covenant extends to personal clients recruited through the employee's independent efforts (See *BDO Seidman v Hirshberg*, 93 N.Y.2d 382(1999).

## II. PARAMETERS OF THE "REASONABLENESS" TEST

**A. Ancillary to an employment contract.** Judicial disfavor of restrictive covenants in the employment context is “provoked by considerations of public policy that militate against sanctioning the loss of a man’s livelihood.” Thus, in addition to examining the reasonableness of the covenant, the court also looks at whether the covenant is harmful to the general public or unreasonably burdensome to the employee. *Reed, Roberts Assoc., Inc. v. Strauman*, 40 N.Y.2d 303 (1976).

### 1. *Covenants Held Reasonable*

*Natsource LLC v. Paribello*, 151 F.Supp.2d 465 (S.D.N.Y. 2001) (one- to three-month nationwide noncompetition agreement held reasonable because the nature of a business in which there are only a finite number of customers over which all brokers compete requires an unlimited geographic restriction); *Lumex Inc. v. Highsmith*, 919 F. Supp. 624 (E.D.N.Y. 1996) (six-month non-competition restriction held reasonable where high-level technical employee would be compensated his base salary while restriction was in effect); *John Hancock Mut. Life Ins. Co. v. Austin*, 916 F. Supp 158 (N.D.N.Y. 1996) (non-competition provision contained within collective bargaining agreement prohibiting former insurance representative from contacting former employer's clients within representative's former district for a period of two years held reasonable and enforceable); *Innovative Networks Inc. v Satellite Airlines Ticketing Centers, Inc.*, 871 F. Supp. 709 (S.D.N.Y. 1995) (one-year nationwide non-competition agreement held reasonable in light of plaintiff’s business); *HBD, Inc. v. Ryan*, 642 N.Y.S.2d 913 (N.Y. App. Div. 1996) (non-competition provision precluding former employee from preparing tax returns for former employer’s customers within a twenty-five-mile radius for a two-year period held reasonable and enforceable); *Continental Group, Inc. v. Kinsley*, 422 F. Supp. 838 (D. Conn. 1976) (applying New York law)

(covenant prohibiting engineer from engaging in similar employment for a period of eighteen months in Canada, the United States, Western Europe and Japan found reasonable as to time and geographic constraints; scope of prohibited activities modified and enforced to the extent reasonable); *Coolidge Co. v. Mokrynski*, 472 F.Supp. 459 (S.D.N.Y. 1979) (restrictive covenant between mailing list broker and its employee prohibiting competition for two years in states east of the Mississippi River found reasonable as to geographic scope, but unreasonable as to time and scope of prohibited activities; modified and enforced to the extent reasonable); *Gelder Medical Group v. Webber*, 41 N.Y.2d 680 (1977) (covenant not to compete within 35-mile radius for five years upheld); *Business Intelligence Servs. Inc. v. Hudson*, 580 F.Supp. 1068 (S.D.N.Y. 1984) (upholding covenant despite unlimited geographic scope in light of the international nature of employer's business); *IBM v. Papermaster*, 2008 U.S. Dist. LEXIS 95516 (2008) (upholding a one-year, world-wide restriction because employee's services were unique and he had confidential information that would be valuable to a competitor, and the nature of the employer's business required that the restriction be unlimited in geographic scope).<sup>2</sup> *Ivy Mar Co., Inc. v. C.R. Seasons Ltd.*, 907 F. Supp. 547 (E.D.N.Y. 1995) (non-compete agreement prohibiting former employee from selling or importing competing goods effectually throughout the world for a period of six years held unreasonably overbroad); *Karpinski v. Ingrassi*, 268 N.E.2d 751 (N.Y. 1971) (covenant prohibiting oral surgeon from practicing in five counties unlimited as to time found unreasonably broad; equitably modified so as to prohibit only the practice of dentistry in such counties).

## 2. *Covenants Held Unreasonable*

*Ivy Mar Co., Inc. v. C.R. Seasons Ltd.*, 907 F. Supp. 547 (E.D.N.Y. 1995) (non-compete agreement prohibiting former employee from selling or importing competing goods effectively throughout the world for a period of six years held unreasonably overbroad); *Karpinski v. Ingrassi*, 268 N.E.2d 751 (N.Y. 1971) (covenant prohibiting oral surgeon from practicing in five counties unlimited as to time found unreasonably broad; equitably modified so as to prohibit only the practice of dentistry in such counties). *Good Energy, L.P. v. Kosachuk*, 2008 NY Slip Op 2031 (N.Y. App. Div. 1st Dep't 2008) (covenant not to compete was reasonable in terms of duration (five years) but unreasonable in terms of geographic area (the entire United States), since the former employer operated

in only eight states); *Reed, Roberts Assoc. Inc., v. Strauman*, 40 N.Y.2d 303 (1976) (refusing to enforce restrictive covenant preventing former employee from engaging in competing business with employer for three years post-termination in the city of New York and three nearby counties because there were no trade secrets involved, nor were the employee's services unique or extraordinary, and further refusing to enforce covenant which would have prevented employee from soliciting any of former employer's customers indefinitely because the names of potential customers were readily discoverable through public sources); *Columbia Ribbon & Carbon Mfg. Co.*, 42 N.Y.2d 496 (1977) (covenant not to compete for two years in any territory which employee was assigned in last two years of employment unreasonable because limitation not tied to uniqueness, trade secrets, confidentiality or competitive unfairness); *Purchasing Associates v. Weitz*, 13 N.Y.2d 267 (1963) (two-year restriction preventing employee from competing with employer within 300-mile radius of New York City unenforceable because employee's services were not unique).

## **B. Incidental to the sale of a business.**

### **1. Covenants Held Reasonable**

*Borne Chemical Co. v. Dictrow*, 445 N.Y.S.2d 406 (N.Y. App. Div. 1981) (covenant in employment contract executed in connection with the sale of a product packaging business prohibiting competition for three years after the employee's termination of employment in any state in which the company operates at the time of termination enforced to the limited extent requested by the employer, i.e., a 150-mile radius of its New York office); *Standard Slide Corp. v. Appel*, 180 N.Y.S. 431 (N.Y. App. Div. 1920) (covenant incidental to sale of mica slide business prohibiting competition for five years in the entire United States except for New Mexico upheld); *Diamond Match Co. v. Roeber*, 13 N.E. 419 (N.Y. 1887) (covenant incidental to sale of match business covering the entire United States except for the state of Nevada and territory of Montana for a 99-year period valid and enforceable).

## **III. GENERAL COMMENTS**

**A. Protectible Interests.** New York courts have limited the employer interests which can justify the imposition of post-employment restraints to (1) protection of confidential customer information, (2) protection of trade secrets, (3) protection of an employer's client base, and (4) protection against irreparable harm where an employee's services are unique or

extraordinary. *Silipos, Inc. v. Bickel*, 2006 U.S. Dist. LEXIS 54946 (2006) (citing *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382 (1999)). Customer lists are protectible only if they constitute trade secrets or confidential material, and are not readily ascertainable from a nonconfidential source. *Briskin v. All Seasons Servs., Inc.*, 615 N.Y.S.2d 166 (1994). Cf. *J.H. Goldberg Co. v. Stern*, 385 N.Y.S.2d 427 (N.Y. App. Div. 1976); *Service Systems Corp. v. Harris*, 341 N.Y.S.2d 702 (N.Y. App. Div. 1973) (stating that “an employer has sufficient interest in retaining present customers to support an employee covenant where the employee's relationship with the customers is such that there is a substantial risk that the employee may be able to divert all or part of the business”); *Greenwich Mills Co. v. Barrie House Coffee Co.*, 459 N.Y.S.2d 454 (N.Y. App. Div. 1983); *ABC Mobile Brakes, Div. of D. A. Mote, Inc. v. Leyland*, 446 N.Y.S.2d 660, 661 (N.Y. App. Div. 1981).

- B. Trade Secrets.** New York courts define trade secrets as “any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.” *Ashland Mgmt. Inc. v. Janien*, 82 N.Y.2d 395 (1993) (quoting Restatement (Second) of Torts § 757, cmt. b (1979)). The six factors under the Restatement are: “(1) the extent to which the information is known outside of the business; (2) the extent to which it is known by employees and others involved in the business; (3) the extent of measures taken by the employer to guard the secrecy of the information; (4) the value of the information to the employer and to his competitors; (5) the amount of effort or money expended by the employer in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.” The most important factor, however, is whether the plaintiff can show that it took measures to protect the secret nature of its information. *Geritrex Corp. v. Dermarite Indus., LLC*, 910 F.Supp. 955 (1996); See also *Ivy Mar Co., Inc. v. C.R. Seasons Ltd.*, 907 F. Supp. 547, 556 (E.D.N.Y. 1995).

However, in the context of restrictive covenants, “trade secrets” does not “encompass nearly all confidential business documents.” *Marietta Corp. v. Fairhurst*, 301 A.D.2d 734 (N.Y. App. Div. 2003). Further, mere “knowledge of the intricacies of a business operation” does not constitute a trade secret. *Silipos, Inc. v. Bickel*, 2006 U.S. Dist. LEXIS 54946 (2006) (quoting *Catalogue Serv. of Westchester, Inc. v. Henry*, 107 A.D.2d 783 (N.Y. App. Div. 1985)).

- C. Uniqueness.** Even where there are no trade secrets or confidential material, a covenant may be enforceable if the former employee's services

are unique or extraordinary. *Shearshon Lehman Bros., Inc. v. Schmetzler*, 116 A.D.2d. 216 (1986). “In analyzing whether an employee’s services are unique, the focus today is less on the uniqueness of the individual person of the employee, testing whether such person is extraordinary [but instead] is more focused on the employee’s relationship to the employer’s business to ascertain whether his or her services and value to that operation may be said to be unique, special or extraordinary [and] must of necessity be on a case-by-case basis.” *Ticor Title Insurance Co. v. Cohen*, 173 F.3d 63, 65 (2d Cir. 1999). See *Savannah Bank, N.A. v. Savings Bank of Fingerlakes*, 691 N.Y.S.2d 227 (N.Y. App. Div. 1999) (the services of two bank loan officers were not sufficiently unique to support the enforceability of covenants not to compete); *Columbia Ribbon & Carbon Mfg. Co. v. A-1-A Corp.*, 369 N.E.2d 4 (N.Y. 1977); *Purchasing Assocs., Inc. v. Weitz*, 196 N.E.2d 245 (N.Y. 1963). Generally, employees whose services are considered unique include “musicians, professional athletes, actors and the like.” *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63 (2d Cir. 1999). Additionally, the uniqueness requirement has been interpreted to reach members of the “learned professions.” See e.g., *Karpinski v. Ingrassi*, 28 N.Y.2d 45 (1971).

- D. Severability:** New York courts usually will enforce an unreasonably broad restrictive covenant to the extent it is reasonable. *Karpinski v. Ingrassi*, 268 N.E.2d at 754-55 (N.Y. 1971) (enforcing a covenant not to compete in the field of dentistry generally by prohibiting defendant from practicing the more narrow practice of oral surgery, plaintiff’s particular specialty); Cf. *AM Media Communications Group v. Kilgallen*, 261 F.Supp.2d 258 (S.D.N.Y. 2003) (declining to “blue-pencil” a two-year restriction with no geographic limitation finding the agreement overreaching as a whole); *Great Lakes Carbon Corp. v. Koch Indus., Inc.*, 497 F. Supp. 462 (S.D.N.Y. 1980) (covenant not enforceable to any extent where found to be unconscionably broad).

When “the unenforceable portion is not an essential part of the agreed exchange, a court should conduct a case specific analysis, focusing on the conduct of the employer in imposing the terms of the agreement. Under this approach, if the employer demonstrates an absence of overreaching, coercive use of dominant bargaining power, or other anti-competitive misconduct, but has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing, partial enforcement will be justified.” *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382 (1999). See also Restatement [Second] of Contracts §184. New York courts have rejected the “judicial blue pencil” doctrine, which requires strict divisibility before a covenant may be partially enforced. *Id.*

- E. Sale of a business:** A non-competition agreement ancillary to an employment contract will be upheld only in certain limited situations (i.e., where trade secrets confidential customer lists or unique or extraordinary services are involved), so it is imperative that a covenant incidental to the sale of a business/retained employee situation be considered ancillary to the sale of a business rather than to an employment contract. See *Borne Chemical Co. v. Dictrow*, 445 N.Y.S.2d at 412; *Standard Slide Corn v. Appel*, 180 N.Y.S. 431 (N.Y. App. Div. 1920). If a non-competition covenant ancillary to the sale of a business is violated, it may constitute proof of irreparable injury for purposes of a preliminary injunction. See *Frank May Assocs. v. Boughton*, 721 N.Y.S.2d 152 (N.Y. App. Div. 2001).
- F. Consideration:** Under New York law, continued employment of an at-will employee or independent contractor for a substantial period of time after the covenant is given is sufficient consideration to support the covenant. See *Zellner v. Conrad*, 589 N.Y.S.2d 903 (N.Y. App. Div. 1992); see also *Ikon Office Solutions v. Leichtnam*, 2003 U.S. Dist. LEXIS 1469 (W.D.N.Y. 2003) (denying defendant employee's motion to dismiss because, among other reasons, the at-will employee's continued employment was adequate consideration to support the covenant not to compete). Continued eligibility for incentive compensation also provides the necessary consideration. *International Paper Co. v. Suwyn*, 951 F. Supp. 445 (S.D.N.Y. 1997).
- G. Forfeiture provisions:** A forfeiture clause is unreasonable as a matter of law when an employee has been terminated without cause. See *Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 397 N.E.2d 358 (N.Y. 1979) (holding that forfeiture of pension benefits under a non-compete agreement by an employee who was involuntarily discharged by his employer without cause and thereafter entered into competition with his former employer was unreasonable as a matter of law); see, *Weiner v. Diebold Group, Inc.*, 568 N.Y.S.2d 959 (1<sup>st</sup> Dep't 1991) (rule extended to "forfeiture of earned wages (including commissions)); *Cray v. Nationwide Mutual Insurance Company*, 136 F.Supp. 2d 171, 179 (W.D.N.Y. 2001) (not extended to bonuses or other benefits payable at the discretion of the employer, such as stock options); *International Business Machines Corporation v. Martson*, 37 F.Supp.2d 613 (S.D.N.Y. 1999) (exercised stock options were not wages for purposes of invalidating the forfeiture provision; and in this context, forfeiture is not appropriate where the stock options are considered earned wages. But options are generally not considered wages in an incentive stock award plan).

New York courts have adopted the **employee choice doctrine**, which applies when an employer conditions receipt of post-employment benefits

on compliance with a restrictive covenant. The employee choice doctrine distinguishes between a covenant not to compete, whereby a former employee may be enjoined from competing, and a condition which forces the former employee to choose between not competing and sustaining monetary losses due to a forfeiture of some benefit. *Sarnoff v. American Home Prods. Corp.*, 798 F.2d 1075 (7th Cir. 1986) (applying New York law). See also *Lucente v. International Business Machines Corporation*, 310 F.3d 243, 254 (2d Cir. 2002) (“New York courts will enforce a restrictive covenant without regard to its reasonableness if the employee has been afforded the choice between not competing (and thereby preserving his benefits) or competing (and thereby risking forfeiture)”). Thus, where an employee voluntarily resigns and proceeds to work for a competitor, the court will uphold a forfeiture provision without regard to reasonableness. *Morris v. Schroder Capital Mngmt. Int’l*, 859 N.E.2d 503 (N.Y. Ct. of App. 2006). Conversely, the employee choice doctrine will not apply where the employer has involuntarily terminated the employee without cause (i.e. where the employee has not been given a choice). In this situation, the forfeiture provision will not be upheld. Furthermore, the question of whether the employee was involuntarily terminated without cause is generally not suitable for summary judgment. *Cray*, 136 F. Supp. 2d at 255.

To determine whether an employee has “voluntarily” resigned, courts apply the “**constructive discharge**” test. *Morris*, 859 N.E.2d at 507. If the court finds that the employer made the working conditions “so difficult or unpleasant that a reasonable person in the employee’s shoes would have felt compelled to resign,” the court will not apply the employee choice doctrine. *Id.* Thus, where an employee has been constructively discharged, the court will examine the reasonableness of the restrictive covenant. *Id.*

**ERISA** also affects the validity of forfeiture provisions. Under 29 U.S.C. § 1053, a benefit that qualifies as retirement income or a pension plan governed by ERISA may not be forfeited. 29 U.S.C. § 1053 (2003); See also *International Paper Co. v. Suwyn*, 978 F.Supp. 506, 510 (S.D.N.Y. 1997). Generally, “top hat plans,” are exempt from some of the ERISA requirements and therefore may be forfeited for violating a noncompete agreement. Top hat plans are “unfunded and maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.” See *Demery v. Extebank Deferred Compensation Plan (B)*, 216 F.3d 283, 286-87 (2d Cir. 2000) (quoting 29 U.S.C. § 1051(2)).

- H. Involuntary termination:** New York courts will not enforce a non-competition agreement where the former employee has been involuntarily discharged without cause. *See, In re UFG International, Inc.*, 225 B.R. 51, 55-56 (S.D.N.Y. 1998); *SIFCO Industries, Inc. v. Advanced Plating Technologies, Inc.*, 867 F.Supp. 155 (S.D.N.Y. 1994); *Weintraub, et al. v. Schwartz*, 516 N.Y.S.2d 946 (N.Y. App. Div. 1987). Where an employer terminates an employee without cause, he “destroys the mutuality of obligation on which the covenant rests, as well as the employer’s ability to impose a forfeiture.” *Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 397 N.E.2d 358 (N.Y. 1979). As noted above, the employee choice doctrine does not apply when an employee has been involuntarily discharged without cause, and the courts will refuse to enforce a forfeiture. *Morris v. Schroder Capital Mngmt. Int’l*, 2006 N.Y. Slip Op 8638 (2006). An employer’s financial problems do not constitute “cause” for termination, which would allow the employer to enforce the non-compete. *In re UFG Int’l Inc.*, 225 B.R. 51 (Bankr. S.D.N.Y. 1998).
- I. Professionals/law firm partnerships:** “With agreements not to compete between professionals . . . we have given greater weight to the interests of the employer in restricting competition within a confined geographical area. In *Gelder Med. Group v. Webber* and *Karpinski v. Ingrasci*, we enforced total restraints on competition, in limited rural locales, permanently in *Karpinski* and for five years in *Gelder*. The rationale for the differential application of the common-law rule of reasonableness expressed in our decisions was that professionals are deemed to provide ‘unique or extraordinary’ services.” *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 389 (1999) (citations omitted). In the context of law practice, however, non-compete agreements are reviewed more strictly. “Law firm partnership agreements represent an exception to the liberality with which we have previously treated restraints on competition in the learned professions (see, *Cohen v Lord, Day & Lord*, 75 N.Y.2d 95; *Denburg v Parker Chapin Flattau & Klimpl*, 82 N.Y.2d 375). Our decisions invalidating anti-competitive clauses in such agreements were not based on application of the common-law rule, but upon enforcement of the public policy reflected in DR 2-108 (A) of the Code of Professional Responsibility (see, 22 NYCRR 1200.13).” *BDO Seidman*, 93 N.Y.2d at 390 n. 1 (partially enforcing a non-compete provision requiring a former employee-accountant to pay liquidated damages for providing services to former clients of his accounting firm). Where the effect of a forfeiture or penalty provision in a lawyer’s employment or partnership agreement is to improperly deter competition, such a restriction on the practice of law will not be enforced by New York courts. *See Denburg v. Parker Chapin Flattau & Klimpl*, 624 N.E.2d 995 (N.Y. 1993) (a restriction providing that withdrawing partners practicing law in the private sector pay penalty to

former firm was held unenforceable); *Judge v. Bartlett, Pontiff, Stewart & Rhodes P.C.*, 610 N.Y.2d 412 (N.Y. App. Div. 1994) (termination benefits forfeiture provision prohibiting departing partner from competing within fifteen miles of any office of former firm for a five-year period held unenforceable); *but see Hackett v. Milbank, Tweed, Hadley & McCoy*, 654 N.E.2d 95 (N.Y. 1995) (forfeiture provision held enforceable where departing lawyer's supplemental withdrawal benefits were merely reduced by amount of new yearly income exceeding one hundred thousand dollars). Indirect prohibitions on the practice of law involving financial disincentives may be enforceable depending on the particular facts and circumstances of the case. Furthermore, these rules apply not only to partnership agreements or employment agreements, but to *any* agreements between lawyers, including shareholder, operating or other similar types of agreements. *Nixon Peabody, LLP v. de Senilhes*, 2008 N.Y. Slip Op. 51885U (2008).

- J. Choice of Law:** New York courts will generally honor a contractual choice-of-law provision as long as the jurisdiction whose law is to be applied bears a reasonable relationship to the dispute, and no fraud nor violation of fundamental public policy of the state of New York would result. In order to bear a reasonable relationship to the dispute, the state selected in the contract must have sufficient contacts with the transaction. *See Legal Sea Foods, Inc. v. Calise*, 2003 WL 21991588 (S.D.N.Y. 2003) (under NY choice-of-law rules, the district court honored the contractual provision to use Massachusetts law in determining the enforceability of the non-compete agreement); *ServiceMaster Residential/Commercial Services, L.P. v. Westchester Cleaning Services, Inc.*, 2001 WL 396520 (S.D.N.Y. 2001) (under NY choice-of-law rules, the court honored the contractual provision to use Tennessee law in determining the enforceability of the non-compete agreement); *but see SG Cowen Securities Corp. v. Messih*, 2000 WL 633434 (S.D.N.Y. 2000) (declining to follow contractual choice-of-law provision based on the exemption in NY Gen. Oblig. Law §5-1401 for agreements involving "labor or personal services" and because California contacts predominated over New York contacts); *Gambar Enterprises, Inc. v. Kelly Services, Inc.*, 418 N.Y.S.2d 818 (N.Y. App. Div. 1979) (inclusion of a "choice of law" provision in a non-competition agreement will affect, but not necessarily determine, the law that will be applied in determining the validity of the agreement).
- K. Noteworthy articles and/or publications:** In Most States, Covenants Not to Compete Will be Enforced If They are Necessary to Protect a Legitimate Business Interest of the Employer, Employment Law Yearbook §15:3:2, (2002). New York State and City Employment Law, 680 PLI.Lit

763 (2002); Non-Compete Agreements: Weighing the Interests of Profession and Firm, 53 Ala. L. Rev 1023 (2002).

- L. Noteworthy cases summarizing scope of permissible/impermissible restraints:** *Reed, Roberts Assocs., Inc. v. Strauman*, 40 N.Y.2d 303, 353 N.E.2d 590, 386 N.Y.S.2d 677 (1976); *Purchasing Associates, Inc. v. Weitz*, 13 N.Y.2d 267, 196 N.E.2d 245, 247-48, 245 N.Y.S.2d 600 (1963); *Morris v. Schroder Capital Mngmt. Int'l*, 859 N.E.2d 503 (N.Y. Ct. of App. 2006) (explaining the employee choice doctrine).

## NORTH CAROLINA

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## NORTH CAROLINA

### I. SUMMARY OF THE LAW

In order to be enforceable, a covenant restraining an employee must be: (1) in writing; (2) made part of an employment contract; (3) based upon valuable consideration; (4) reasonable both as to time and territory; and (5) not against public policy. To determine what is reasonable, courts look at the facts and circumstances of each particular case. With respect to public policy, an individual's right to earn a living outweighs the employer's right to protection, against competition. Therefore, the employer has the burden of proving the reasonableness of the restriction. *United Labs. Inc. v. Kuykendall*, 370 S.E.2d 375 (N.C. 1988). See also *Hanover Rent-A-Car, Inc. v. Martinez*, 525 S.E.2d 487 (N.C. 2000) (requirement that a covenant not to compete be in writing explicitly "includes a requirement that the writing be signed."); N.C. Gen. Stat. § 75-4 (1988) (covenants against competition must be in writing and signed by the employee).

In general, covenants not to compete between employer and employee are not viewed favorably in modern law under North Carolina jurisprudence. *Farr Assocs., Inc. v. Baskin*, 530 S.E.2d 878 (N.C. Ct. App. 2000).

Under North Carolina law, covenants not to compete must be reasonable both as to geographic and temporal restrictions, and courts must analyze these two restrictions in tandem. *Precision Walls, Inc. v. Servie*, 568 S.E.2d 267 (N.C. App. 2002). In determining whether the geographic scope of a covenant not to compete is reasonable, the court shall consider: (1) the area or scope of the restriction; (2) the area assigned to the employee; (3) the area where the employee actually worked; (4) the area in which the employer operated; (5) the nature of the business involved; and (6) the nature of the employee's duty and his knowledge of the employer's business operation. *Farr Assocs., Inc.*, 530 S.E.2d at 882 (citing *Hartman v. W.H. Odell and Assocs., Inc.*, 450 S.E.2d 912, 917 (N.C. App. 1994), review denied, 454 S.E.2d 251 (1995)).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Precision Walls, Inc.*, 568 S.E.2d 267 (holding that a one year, two state restriction in a covenant not to compete was reasonable); *Market Am., Inc. v. Christman-Orth*, 520 S.E.2d 570 (N.C. App. 1999) (finding that 6 month covenant not to compete with no geographic restriction was not "unreasonable as a matter of law"); *Triangle Leasing Co. v. McMahon*, 393 S.E.2d 854 (N.C. 1990) (two-year restriction from soliciting former employer's customers in state enforced); *United Labs.*, 370 S.E.2d 375 (18-month restriction on soliciting former employer's customers upheld); *Amdar. Inc. v.*

*Satterwhite*, 246 S.E.2d 165 (N.C. App. 1978) (one-year, 25-mile radius restriction upheld), cert. denied, 248 S.E.2d 249 (1978); *Schultz & Assocs. of the Southeast v. Ingram*, 248 S.E.2d 345, 350 (N.C. App. 1978) (covenant covering employer's entire multi-state area upheld); *Forrest Paschal Mach. v. Milholen*, 220 S.E.2d 190 (N.C. App. 1975) (two-year, 350-mile radius restriction upheld); *Wilmar, Inc. v. Corsillo*, 210 S.E.2d 427 (N.C. App. 1974) (one year, selling territory restriction upheld), cert. denied, 211 S.E.2d 802 (1975);

2. *Static Control Components, Inc. v. Darkprint Imaging, Inc.*, 240 F. Supp.2d 465 (M.D. N.C. 2002) (applying North Carolina law and finding that 2 year covenant with no geographic restriction was unreasonable); *Manual Woodworkers & Weavers, Inc. v. The Rug Barn, Inc.*, No. 1:00cv284-C, 2001 WL 1672253 (W.D. N.C. Dec. 19, 2001) (noting that plaintiff attempted to "impose a geographic limitation, which was based on marketing, to employees who were engaged in manufacturing[,] and finding non-compete agreement to be overly broad and "unenforceable as a matter of law"); *Farr Assocs., Inc.*, 530 S.E.2d at 883 (holding that the scope of the client-based territorial restriction, which prevented employee from working for all of former employer's current or recent clients, was unreasonable, rendering the non-compete agreement unenforceable); *Nalle Clinic Co. v. Parker*, 399 S.E.2d 363 (N.C. App. 1991) (two-year, one-county restriction against doctor with pediatric specialty unreasonable); *Electrical S., Inc. v. Lewis*, 385 S.E.2d 352 (N.C. App. 1989) (covenant with potential world-wide effect unreasonable); *Masterclean of North Carolina, Inc. v. Guy*, 345 S.E.2d 692 (N.C. App. 1986) (holding a covenant restricting employee from engaging in similar business in any city or state of the United States in which employer then operated or intended to operate "patently unreasonable"); *Starkings Court Reporting Serv., Inc. v. Collins*, 313 S.E.2d 614 (N.C. App. 1984) (court reporter hired as "independent contractor;" covenant unreasonable where it restricted reporter from working in county or within 50-mile radius for two years); .

## **B. Incidental to the sale of a business.**

1. *Kennedy v. Kennedy*, 584 S.E.2d 328 (N.C. App. 2003) (finding three year, fifteen mile radius restriction "wholly reasonable"); *Bicycle Transit Auth., Inc. v. Bell*, 333 S.E.2d 299 (N.C. App. 1985) (seven-year, two-county restriction enforced); *Jewel Box Stores v. Morrow*, 158 S.E.2d 840 (N.C. 1968) (10-year, 10-mile restriction

upheld); *Thompson v. Turner*, 96 S.E.2d 263 (N.C. 1957) (restriction from operating in buyer's city or territory upheld); *Sineath v. Katzis*, 12 S.E.2d 671 (N.C. 1940) (covenant preventing officer of seller from operating competing business within county for 15 years enforceable). See also *Keith v. Day*, 343 S.E.2d 562 (N.C. App. 1986) (in proposed-joint venture arrangement, covenant extending for two years and restricted to municipality where parties resided enforced).

### III. GENERAL COMMENTS

- A. Protectable interests: customer contacts and relationships, goodwill, trade secrets, technical knowledge and most likely other confidential information that does not rise to the level of a trade secret. *Farr Assocs., Inc.*, 530 S.E.2d at 881; *United Labs.*, 370 S.E.2d at 380-81 (restrictive covenants in employment relationships valid if the employee will come into contact with employer's customers or will be exposed to confidential information); *Young v. Mastrom. Inc.*, 392 S.E.2d 446, 449 (N.C. App. 1990) (employer's protectable interests extend beyond trade secrets).

But note: An employer does not have a legitimate protectable interest in merely preventing ordinary competition from a former employee. *Cox v. Dine-A-Mate, Inc.*, 501 S.E.2d 353, 356 (N.C. App. 1998).

- B. If a covenant is overbroad, it will not be enforced and the court will not reform it. *Digital Recorders v. McFarland*, 2007 NCBC LEXIS 23 (N.C. Sup. Ct. 2007). If, however, the contract is severable, and one provision is reasonable, the court will enforce the reasonable provision. *Whittaker Gen. Med. Corp. v. Daniel*, 379 S.E.2d 824, 828 (N.C. 1989).
- C. When an ambiguity is present in a covenant not to compete, the court is to construe the ambiguity against the drafter (i.e., the party responsible for choosing the questionable language). *Novocare Orthotics & Prosthetics E., Inc. v. Speelman*, 528 S.E.2d 918 (N.C. App. 2000).
- D. Reasonable covenants not to compete are enforceable against independent contractors. *Market Am., Inc.*, 520 S.E.2d at 578.
- E. Mootness: Plaintiff can only seek to enforce a covenant not to compete under North Carolina law for the period of time within which the covenant proscribes. *Rug Doctor, L.P. v. Prate*, 545 S.E.2d 766 (2001). See also *Artis & Assocs. V. Auditore*, 572 S.E.2d 198 (N.C. App. 2002) (citing *Rug Doctor*, 545 S.E.2d at 768); *Corpening Ins. Center, Inc. v. Haaff*, 573 S.E.2d 164 (N.C. App. 2002) (citing *Rug Doctor*, 545 S.E.2d at 768).

- F.** Under North Carolina law, “the promise of new employment is valuable consideration in support of a covenant not to compete.” *Farr Assocs., Inc.*, 530 S.E.2d at 881. When a covenant not to compete is part of the original verbal employment contract, it is supported by consideration despite the fact that the contract is not actually signed until some time after employment has begun. *Wade S. Dunbar Ins. Agency, Inc. v. Barber*, 556 S.E.2d 331 (N.C. App. 2001) (covenant orally agreed to prior to inception of employment but not actually executed until 1 year after employment began). However, a “covenant entered into after an employment relationship already exists must be supported by new consideration, such as a raise in pay or a new job assignment.” *Reynolds & Reynolds Co. v. Tart*, 955 F.Supp. 547, 553 (W.D. N.C. 1997). Continued employment is not sufficient consideration for a non-compete agreement entered into after the employment relationship has begun. *Cox*, 501 S.E.2d 356; *Forrest Paschal Mach. Co.*, 220 S.E.2d at 190.
- G.** Will a choice of law provision in contract be followed? Yes. See *Buettel v. Lumber Mut. Ins. Co.*, 518 S.E.2d 205, 209 (N.C. App. 1999) (stating that “[c]hoice of law provisions are not contrary to the laws of this state” and “[t]he parties’ intent must rule.”). See also *Redlee/SCS, Inc. v. Pieper*, 571 S.E.2d 8 (N.C. App. 2002) (applying Texas law pursuant to the terms of the employment agreement); *UBS Painewebber, Inc. v. Aiken*, 197 F.Supp.2d 436 (W.D. N.C. 2002) (applying New York law pursuant to the choice of law provision in the contract).
- However, a forum selection clause will not be enforced if the clause was the product of unequal bargaining power and enforcement of the clause would be unfair and unreasonable. *Cox*, 501 S.E.2d at 355-56 (refusing to enforce the forum selection clause).
- H.** Noteworthy articles/publications: Bret L. Grebe, Fidelity at the Workplace: The Two-Faced Nature and Duty of Loyalty under *Dalton v. Camp*, 80 N.C. L. Rev. 1815 (June 2002); Jason S. Wood, A Comparison of the Enforceability of Covenants Not to Compete and Recent Economic Histories of Four High Technology Regions, 5 Va. J.L. & Tech. 14 (Fall 2000) (focusing on California, Massachusetts, North Carolina, and Texas); John Reid Parker, Jr., Injunctive Russian Roulette and Employment Non-Competition Cases: *A.E.P Industries, Inc. v. McClure*, 63 N.C. L. Rev. 222 (Nov. 1984).

## NORTH DAKOTA

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## **NORTH DAKOTA**

### **I. OVERVIEW OF THE LAW**

#### **A. Statutory Statement of the Law**

N.D. Cent. Code § 9-08-06.

“In restraint of business void -- Exceptions. Every contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind is to that extent void, except:

1. One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business within a specified county, city, or a part of either, so long as the buyer or any person deriving title to the goodwill from him carries on a like business therein;
2. Partners, upon or in anticipation of a dissolution of the partnership, may agree that all or any number of them will not carry on a similar business within the same city where the partnership business has been transacted, or within a specified part thereof.”

#### **B. Judicial Statement of the Law**

Applying this statute, North Dakota courts will not enforce non-compete covenants which are ancillary to employment agreements whenever such covenants effectively prohibit employees from competing, regardless of the contract's reasonableness. *See, e.g., Werlinger v. Mutual Service Cas. Ins.*, 496 N.W.2d 26 (N.D. 1993); *Spectrum Emergency Care, Inc. v. St. Joseph's Hospital & Health Care Center*, 479 N.W.2d 848 (N. D 1992).

### **II. CONSIDERATION ISSUES**

Standard consideration issues are largely inapplicable because the North Dakota legislature, and consequently the North Dakota courts, repudiate post-employment restrictive covenants except in very limited, statutorily-defined circumstances. Therefore, questions concerning the adequacy of consideration at the commencement of employment, whether continued employment can constitute sufficient consideration, and like inquiries, are inapplicable.

### **III. PARAMETERS OF THE STATUTE AND GOVERNING LAW**

#### **A. Incidental to the sale of a business**

1. See N.D. Cent. Code § 9-08-06 (statutorily limits the geographic

scope of a restrictive covenant to a "city, county, or a part of either ... so long as the buyer carries on a like business therein").

2. *Earthworks, Inc. v. Sehn*, 553 NW 2d 490 (N.D. 1996) (limited application of covenant to work performed in single county); *Lire, Inc. v. Bob's Pizza Inn Restaurants, Inc.*, 541 N.W.2d 432 (N.D. 1995) (50-mile radius from single city too broad); *Herman v. Newman Signs, Inc.*, 417 N.W.2d 179, 180 (N.D. 1987) (ten-year, state-wide restriction was overbroad; limited to single county); *Hawkins Chem., Inc. v. McNea*, 321 N.W.2d 918, 920 (N.D. 1982) (temporally indefinite six-state restriction was limited to county where business was located).

#### IV. GENERAL COMMENTS

- A. **Choice of Law:** Whether a choice of law provision in a contract will be followed depends upon whether the particular state's substantive law conflicts with the public policy regarding restrictive covenants in North Dakota. See *Forney Industries, Inc. v. Andre*, 246 F. Supp. 333 (D.N.D. 1965).
- B. **Forfeiture of Benefits:** A forfeiture of benefits provision is treated as a restraint of trade under North Dakota law. As such, it is subject to the same analysis as other non-competition covenants and, in the employment context, is void and unenforceable under § 9-08-06. *Werlinger v. Mut. Serv. Cas. Ins. Co.*, 496 N.W.2d 26, 28-30 (N.D. 1993). However, if the covenant survives the restraint-of-trade scrutiny, a forfeiture clause is valid. See *Kovarik v. American Family Ins. Group*, 108 F.3d 962 (8<sup>th</sup> Cir. 1997).
- C. **Modification:** If a non-competition covenant is overbroad, it may be modified to conform to the provisions of N.D. Cent. Code § 9-08-06(1), thereby making it enforceable. See *Earthworks, Inc. v. Sehn*, 553 NW 2d 490 (N.D. 1996)(sale of business context; covenant's statewide restriction reduced to single county); *Hawkin Chem., Inc. v. McNea*, 321 N.W.2d at 919-20; *Herman v. Newman Signs, Inc.*, 417 N.W.2d at 180; *Igoe v. Atlas Ready-Mix, Inc.*, 134 N.W.2d 511, 519 ( N.D. 1965).
- D. **Non-Solicitation Agreements:** The statutory proscription against non-competition agreements also applies to non-solicitation agreements. *Warner & Co. v. Solberg*, 634 N.W.2d 65 (N.D. 2001) (rejecting prior Eighth Circuit decision applying North Dakota law, which had held the statute did *not* limit employers' rights to impose customer non-solicitation restrictions on former employees, *Kovarik v. American Family Insurance Group*, 108 F.3d 962 (8<sup>th</sup> Cir. 1996)).

- E. Protectible interests:** A buyer may enforce a non-compete agreement incidental to the sale of a business if it acquired goodwill from the seller. N.D. Cent. Code § 9-08-06. "The sale or transfer of good will can be created upon the facts only through implying that the physical property sold was of less value than the consideration paid, and that therefore the difference must represent good will, and that this good will so represented by such value was a part of the consideration in the transfer of the transfer of the [property]". *Brottman v. Schela*, 202 N.W. 132, 134 (N.D. 1925). A sale of 1/200<sup>th</sup> interest in a company cannot be said to transfer the goodwill of a business. *Warner and Company v. Solberg*, 634 N.W.2d 65 (N.D. 2001).
- F. Trade secrets defined:** N.D. Cent. Code Ch. 47-25.1 (Uniform Trade Secrets Act); *Warner and Company v. Solberg*, 634 N.W.2d 65 (N.D. 2001); *Kovarik v. American Family Ins. Group*, 108 F.3d 962 (8<sup>th</sup> Cir. 1997).

## OHIO

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## OHIO

### I. SUMMARY OF THE LAW

#### A. Contracts Ancillary to an Employment Relationship.

A covenant not to compete is enforceable if: (1) the restraint is no greater than that which is required to protect the employer; (2) it does not impose an undue hardship on the employee; and (3) it does not injure the public. *Hamilton Ins. Services, Inc. v. Nationwide Ins. Cos.*, 86 Ohio St. 3d 270, 274, 714 N.E.2d 898, 901 (Ohio 1999); *Raimonde v. Van Vlerah*, 42 Ohio St. 2d 21, 325 N.E.2d 544, 547 (Ohio 1975); *Murray v. Accounting Ctr. & Tax Servs.*, 178 Ohio App. 3d 432, 437, 898 N.E.2d 89, 93 (Ohio Ct. App. 2008); *Columbus Medical Equipment Co. v. Watters*, 13 Ohio App.3d 149, 468 N.E.2d 343, 347 (Ohio Ct. App. 1983). In determining the reasonableness of a covenant, courts consider:

[T]he absence or presence of limitations as to time and space[;] . . . [w]hether the employee represents the sole contact with the customer; whether the employee is possessed with confidential information or trade secrets; whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition; whether the covenant seeks to stifle the inherent skill and experience of the employee; whether the benefit to the employer is disproportional to the detriment to the employee; whether the covenant operates as a bar to the employee's sole means of support; whether the employee's talent which the employer seeks to suppress was actually developed during the period of employment; and whether the forbidden employment is merely incidental to the main employment.

*Extine v. Williamson Midwest*, 176 Ohio St. 403, 406, 200 N.E.2d 297, 299 (Ohio 1964); *overruled on other grounds, Raimonde v. Van Vlerah*, 42 Ohio St. 2d 21, 325 N.E.2d 544 (Ohio 1975).

Under Ohio law, non-compete agreements by employees can be assigned. *Blakeman's Valley Office Equipment, Inc. v. Bierdeman*, 152 Ohio App. 3d 86, 786 N.E.2d 914 (Ohio Ct. App. 2003); *Artromick International, Inc. v. Koch*, 143 Ohio App. 3d 805, 719 N.E.2d 385 (Ohio Ct. App. 2001).

Non-compete agreements with at-will employees are enforceable in Ohio. See, e.g., *Lake Land Empl. Group of Akron, LLC v. Columber*, 101 Ohio St. 3d 242, 248, 804 N.E.2d 27 (Ohio 2004). Consideration exists to support a non-compete agreement when, in exchange for the assent of an at-will employee to a proffered noncompetition agreement, the employer continues an at-will employment relationship that could legally be terminated without cause. Id.

A covenant not to compete that imposes unreasonable restrictions on an ex-employee will be reformed and enforced by a court only to the extent necessary to protect the employer's legitimate interests. *Klaus v. Kilb, Rogal & Hamilton Co. of Ohio*, 437 F. Supp. 2d 706, 732 (S.D. Ohio 2006); *Raimonde v. VanVlerah*, 42 Ohio St. 2d 21, 325 N.E.2d 544, 547 (Ohio 1975).

If an employer has withdrawn from a particular line of business, it cannot enforce non-compete agreements with ex-employees who continue to work in that line of business. See *Premier Assocs., Ltd. v. Loper*, 149 Ohio App. 3d 660, 671, 778 N.E.2d 630 (Ohio Ct. App. 2002).

## **B. Contracts Ancillary to the Sale of a Business.**

Courts will enforce covenants not to compete in order to protect the good will transferred through the sale of the business. *J.D. Nichols Stores, Inc. v. Lipschutz*, 120 Ohio App. 286, 201 N.E.2d 98 (Ohio Ct. App. 1963). Even if there is not a written covenant not to compete, a "reasonable time within which to possess the advantages of the commercial relationship between [buyer] and the former customers of [seller]" must pass before the seller may compete without violating the buyer's rights in the good will purchased from the seller. *Terminal Vegetable Co. v. Beck*, 8 Ohio App. 2d 231, 196 N.E.2d 109, 111 (Ohio Ct. App. 1964).

While the covenant by a seller of a business not to engage in the same business is void where the restraint is general, an agreement which imposes only a partial restraint made in connection with the sale of a business and its goodwill, shown to be reasonably necessary to the enjoyment of the goodwill and not oppressive, is valid and may be enforced. *DiAngelo v. Pucci*, No. 1267, 1987 Ohio App. LEXIS 6318 (Ohio Ct. App. Mar. 31, 1987).

## **II. PARAMETERS OF THE "REASONABLENESS" TEST**

### **A. Ancillary to an employment contract.**

*Rogers v. Runfola & Assoc.*, 57 Ohio St. 3d 5, 9, 565 N.E.2d 540, 544 (Ohio 1991) (court held that covenants were reasonable which, as modified by the court, barred former employees of a court reporting service for one year from competing within Columbus, Ohio city limits and from soliciting clients of former employer); *Brentlinger Enterprises v. Curran*, 141 Ohio App. 3d 640, 652, 752 N.E.2d 994, 1003 (Ohio Ct. App. 2001) (affirming refusal to enforce non-compete because prohibition against using employer's information adequate to protect employer). *The Procter & Gamble Co. v. Stoneham*, 140 Ohio App. 3d 260, 747 N.E.2d 268 (Ohio Ct. App. 2000) (three-year non-compete for management level employee reasonable to protect trade secrets and other information of employer); *Professional Investigations & Consulting Agency, Inc. v. Kingsland*, 69 Ohio App. 3d 753, 759, 591 N.E.2d 1265, 1269 (Ohio Ct. App. 1990) (restrictions "must be no greater than that which is required to protect the employer"); *Columbus Medical Equipment Co. v. Watters*, 13 Ohio App. 3d 149, 468 N.E.2d 343, 347 (Ohio Ct. App. 1983) (court enforced a covenant prohibiting a sales person from competing in a similar business in Ohio for two years).

**B. Incidental to the sale of a business.**

*DiAngelo*, 1987 Ohio App. LEXIS 6318 at \*4 (upholding a fifteen-year restriction incidental to the sale of a business and noting that other courts have upheld restrictions ranging from ten years to "as long as the buyer of a business remains in the city where the subject business was purchased"); *J.D. Nichols Stores, Inc. v. Lipschutz*, 120 Ohio App. 286, 201 N.E.2d 898 (Ohio Ct. App. 1963) (enforcing covenant prohibiting seller from competing with buyer for ten years within city in which the business was located).

**III. GENERAL COMMENTS**

- A.** Protectible interests include goodwill, trade secrets and confidential information, including confidential customer information such as customer lists and knowledge of specific customer requirements. *Briggs v. Butler*, 140 Ohio St. 499, 45 N.E.2d 757, 762 (Ohio 1942); *The Procter & Gamble Co. v. Stoneham*, 140 Ohio App. 3d 260, 747 N.E.2d 268 (Ohio Ct. App. 2000); *Conforming Matrix Corp. v. Faber*, 104 Ohio App. 8, 146 N.E.2d 447, 450 (Ohio Ct. App. 1957); *Extine v. Williamson Midwest*, 176 Ohio St. 403, 406, 200 N.E.2d 297, 299 (Ohio Ct. App. 1964), *overruled on other grounds by Raimonde v. Van Vlerah*, 42 Ohio St. 2d 21, 325 N.E.2d 544 (Ohio 1975); *J.D. Nichols Stores, Inc. v. Lipschutz*, 120 Ohio App. 286, 201 N.E.2d 898 (Ohio Ct. App. 1963).

- B.** If a covenant is overbroad a court may enforce the covenant to the extent necessary to protect the employer's legitimate interests. *Am. Bldg. Serv., Inc. v. Cohen*, 78 Ohio App. 3d 29, 603 N.E.2d 432 (Ohio Ct. App. 1992); see also *Klaus v. Kilb, Rogal & Hamilton Co. of Ohio*, 437 F. Supp. 2d 706, 732 (S.D. Ohio 2006). A court has discretion to modify an overbroad covenant to make it reasonable and enforceable as modified, regardless of whether the unreasonable portions of the covenant are divisible. *Raimonde v. Van Vlerah*, 42 Ohio St. 2d 21, 325 N.E.2d 544, 547 (Ohio 1975); see also *Rogers v. Runfola & Assoc.*, 57 Ohio St. 2d 5, 9, 565 N.E.2d 540, 544 (Ohio 1991). If a court "could not easily modify existing provisions but might be required to rewrite the entire covenant," the trial court may decline to modify the covenant. *Prof'l Investigations & Consulting Agency, Inc. v. Kingsland*, 69 Ohio App. 3d 753, 760, 591 N.E.2d 1265, 1269-70 (Ohio Ct. App 1990).
- C.** Ohio courts of appeals have split on whether continued employment is sufficient consideration for a covenant not to compete and the Ohio Supreme Court has not resolved the conflict. P. Bergeson, Navigating the "Deep and Unsettled Sea" of Covenant Not to Compete Litigation in Ohio: A Comprehensive Look, 31 U. Tol. L. Rev. 373, 382-385 (2000). Most recent cases suggest "that continued employment does provide consideration under Ohio law." *Id.* at 384. Consideration exists to support a noncompetition agreement when, in exchange for the assent of an at-will employee to a proffered noncompetition agreement, the employer continues an at-will employment relationship that could legally be terminated without cause. *Lake Land Empl. Group of Akron, LLC v. Columber*, 101 Ohio St. 3d 242, 248, 804 N.E.2d 27 (Ohio 2004). Changes in the employment relationship will serve as consideration for a covenant not to compete. See *Rogers v. Runfola & Assoc.*, 57 Ohio St. 2d 5, 565 N.E.2d 540 (Ohio 1991) (change from employment at will to terminable for cause employment supported covenant not to compete); *Credit Consultants, Inc. v. Gallagher*, 1991 WL 124357 (Ohio Ct. App. 1991) (change of employment status from "terminable-at-will" to "month-to-month employment" was sufficient consideration to support covenant not to compete), aff'd, 62 Ohio St. 3d 1465, 580 N.E.2d 785 (Ohio 1991); *Columbus Medical Equipment Co. v. Watters*, 13 Ohio App. 3d 149, 150, 468 N.E.2d 343, 346 (1983) (employer increased salary and provided "job related privileges").
- D.** A forfeiture of benefits provision may not be enforced if unreasonable. See *Cad Cam, Inc. v. Underwood*, 36 Ohio App. 3d 90, 521 N.E.2d 498 (Ohio Ct. App. 1987) (refusing to enforce penalty provision which required employee to pay one half of one year's salary as penalty for competition with employer); *Snarr v. Picker Corp.*, 29 Ohio App. 3d 254, 504 N.E.2d

1168 (Ohio Ct. App. 1985) (forfeiture clause in non-contributory profit sharing plan which provided for complete forfeiture of benefits if the employee competed within two years after termination was unreasonable and would not be enforced). *But see Packer, Thomas & Co. v. Eyster*, 126 Ohio App. 3d 109, 117, 709 N.E.2d 922, 926 (Ohio Ct. App. 1998) (enforcing provision requiring employee to pay employer if clients were transferred to new employer); *Keller v. Graphic Systems*, 422 F. Supp. 1005, 1012 (N.D. Ohio 1976) (enforcing forfeiture of retirement benefits resulting from breach of covenant prohibiting competition by former salesman). See Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.*, concerning federal limitations on forfeiture of post-employment benefits.

- E. A covenant not to compete is enforceable if the employee is discharged for cause. *Patterson Int'l Corp. v. Herrin*, 25 Ohio Misc. 79, 264 N.E.2d 361 (1970) (covenant not to compete enforced against employee terminated for eight-day absence). A covenant not to compete is apparently also enforceable against an employee terminated without cause. *Blakeman's Valley Office Equipment, Inc. v. Bierdeman*, 152 Ohio App. 3d 86, 786 N.E.2d 914 (Ohio Ct. App. 2003) (covenant enforced against terminated employee, with no consideration of existence of cause).
- F. Attorneys' fees incurred as a result of a breach of a covenant not to compete may be recovered if the covenant provides for their recovery. *Hilb, Rogal & Hamilton Agency of Dayton, Inc. v. Reynolds*, 81 Ohio App. 3d 330, 610 N.E.2d 1102 (Ohio Ct. App. 1992). In addition, attorneys' fees may be recoverable if the employee has acted in bad faith. *Columbus Medical Equipment Co. v. Watters*, 13 Ohio App. 3d 149, 468 N.E.2d 343, 348 (Ohio Ct. App. 1983) (attorney fees not generally available absent either statute authorizing their recovery or showing of bad faith; here destruction of employment contract by defendant constituted bad faith warranting award of attorneys' fees).
- G. A breach of the employment agreement by the employer should relieve the employee of his or her non-compete obligations. See *Hamilton Ins. Services, Inc. v. Nationwide Ins. Cos.*, 86 Ohio St. 270, 274, 714 N.E.2d 898, 901 (Ohio 1999) (noting that court of appeals had held non-compete unenforceable because of breach of employment agreement, but reversing because of absence of such a breach); P. Bergeron, Navigating the "Deep and Unsettled Sea" of Covenant Not to Compete Litigation in Ohio: A Comprehensive Look, 31 U. Tol. L. Rev. 373, 391 (2000). As a general rule, a material breach of a contract by one party will excuse continued performance by the other. See *Economou v. Physicians Weight*

*Loss Ctrs.*, 756 F. Supp. 1024, 1034 (N.D. Ohio 1991) (material breach of franchise agreement by franchisor would excuse franchisee from further performance of non-competition provisions of franchise agreement); *Barnes Group, Inc. v. O'Brien*, 591 F. Supp. 454, 462-63 (N.D. Ind. 1984) (decided under Indiana and Ohio law) (court enforced explicit contractual provision providing that an alleged breach of contract by seller was no defense to action to enforce covenant not to compete).

- H. Choice of law provisions will be followed. *Neff Athletic Lettering Co. v. Walters*, 524 F. Supp. 268, 273 (S.D. Ohio 1981) (choice of law enforced unless forum selected by parties has no substantial relationship to the transaction).
- I. In 1994, Ohio adopted the Uniform Trade Secrets Act, which is codified at Ohio Rev. Code Ann. §1333.61 *et seq.*
- J. Noteworthy articles and/or publications: P. Bergeron, Navigating the “Deep and Unsettled Sea” of Covenant Not to Compete Litigation in Ohio: A Comprehensive Look, 31 U. Tol. L. Rev. 373, 391 (2000); Making Employee Non-Competition Agreements Unenforceable: Triumph of Labor Mobility or Policy Prescription for Disaster? Cases of Ohio and California With Some Practical Suggestions, 17 Cap. U.L. Rev. 391 (1988).
- K. Noteworthy cases summarizing scope of permissible/impermissible restraints: *Hamilton Ins. Services, Inc. v. Nationwide Ins. Cos.*, 86 Ohio St. 3d 270, 714 N.E.2d 898 (Ohio 1999); *The Procter & Gamble Co. v. Stoneham*, 140 Ohio App. 3d 260, 747 N.E.2d 268 (Ohio Ct. App. 2000); *Columbus Medical Equip. Co. v. Watters*, 13 Ohio App. 3d 149, 468 N.E.2d 343 (Ohio Ct. App. 1983); *Premix v. Zappitelli*, 561 F. Supp. 269 (N.D. Ohio 1983); *Basicomputer Corp. v. Scott*, 791 F. Supp. 1280, 1290-91 (N.D. Ohio 1991), *aff'd*, 973 F.2d 507 (6th Cir. 1992).
- L. A former employer may be estopped from enforcing a noncompetition clause against a former employee where (1) the former employer has given the former employee oral assurances, at the time the employment agreement was signed, that the clause would not be enforced, (2) the former employer reasonably expected those assurances to induce the former employee to sign the agreement, and (3) the employee, who was already working for others, had relied on those assurances when she signed the agreement. *Chrysalis Health Care, Inc. v. Brooks*, 65 Ohio Misc. 2d 32, 41, 640 N.E.2d 915, 921 (Ohio Mun. 1994).
- M. The state’s Code of Professional Responsibility may impose restrictions on the enforcement of covenants not to compete within the legal

profession because such covenants operate to restrict the practice of law.  
A.B.A. Sec. Lab. Emp. L. Rep. 397 (Supp. 1996).

## OKLAHOMA

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## OKLAHOMA

### IV. STATUTORY AUTHORITY

Oklahoma has a statute governing non-compete agreements. OKLA. STAT. ANN. tit. 15, §§ 217 to 219A (West, 2003).

OKLA. STAT. ANN. tit. 15, § 217 states:

Every contract by which any one is restrained from exercising a lawful profession, trade or business of any kind otherwise than as provided by the next two sections, is to that extent void.

OKLA. STAT. ANN. tit. 15, § 218:

ONE who sells the good-will of a business may agree with the buyer to refrain from carrying on a similar business within a specified period county, city, or part thereof, so long as the buyer, or any person deriving to the good-will from him carries on a like business therein.

OKLA. STAT. ANN. tit. 15, § 219:

PARTNERS may, upon or in anticipation of a dissolution of the partnership, agree that none of them will carry on a similar business within the same city or town where the partnership business has been transacted, or within a specified part thereof.

A supplement to §219 became effective on June 4, 2001. OKLA. STAT. ANN. tit. 15 § 219A. This new section allows employees to enter into non-compete agreements with their employers, “but only to the extent ‘the former employee does not directly solicit the sale of goods, services or a combination of goods and services from the established customers of the former employer.’” *Eakle v. Grinnell Corp.*, 272 F. Supp.2d 1304, 1310 (E.D. Okla. 2003) (quoting OKLA. STAT. ANN. tit. 15 § 219A). However, this new provision is not applicable to non-compete agreements entered into prior to June 4, 2001. *Eakle*, 272 F. Supp.2d at 1310.

OKLA. STAT. ANN. tit. 15, § 219A:

- A.** A person who makes an agreement with an employer, whether in writing or verbally, not to compete with the employer after the employment relationship has been terminated, shall be permitted to engage in the same business as that conducted by the former employer or in a similar business as that conducted by the former employer as long as the former employee does not directly solicit the sale of goods, services or a combination of goods and services from the established customers for the

former employer.

- B. Any provision in a contract between an employer and an employee in conflict with the provisions of this section shall be void and unenforceable.

## V. SUMMARY OF LAW

The most meaningful development in non-compete law in Oklahoma has taken place since the Oklahoma Supreme Court's decision in *Bayly, Martin & Fay, Inc. v. Pickard*, 780 P.2d 1168 (Okla. 1989). There, the court determined that only unreasonable restrictions constituted violations of § 217. Since then, Oklahoma courts have examined restrictive covenants to determine whether they are reasonable in terms of time, geographical and activity limitations. If they are not, Oklahoma courts have the equitable power to modify them, but will not do so if the covenant is so flawed that the court would be required to re-write the contract or provide its essential terms. *Vanguard Env'tl., Inc. v. Curler*, P.3d 1158 (Okla. Ct. App. 2007)

## VI. ELEMENTS OF ENFORCEABILITY

### A. Protectable Interest

Unfair competition on the part of a former employee is the legitimate focus of a non-compete agreement in Oklahoma. *Mamma* at 213. Competition becomes unfair when a former employee improperly uses some business advantage or opportunity gained through employment with the former employer with whom they had a non-compete agreement, such as soliciting the former employer's actual customers. *Id*; *Loewen Group Acquisition Corp. v. Matthews*, 12 P.3d 977, 982 (Okla. Ct. App. 2000). Thus, provisions that require a former employee to maintain a "hands-off policy" towards a former employer's actual customers are enforceable. *Mamma* at 213; *Key Temp. Personnel, Inc. v. Cox*, 884 P.2d 1213, 1216 (Okla. Ct. App. 1994). On the other hand, such covenants cannot prevent a former employee from accepting customers of the former employer where no solicitation has occurred, such as where the customers affirmatively request or select the former employee. *Bayly, Martin & Fay, Inc. v. Pickard*, 780 P.2d 1168 (Okla. 1989).

Employers also have a protectable interest in trade secrets. In fact, Oklahoma has adopted the Uniform Trade Secrets Act, OKLA. STAT. ANN. tit. 78, §§ 85-94.

An employer has no protectable interest in attempting to avoid ordinary competition. *Mamma* at 213. As a result, employers have no protectable interests in any expertise, good will, contacts or opportunities

that the employee gained before working for the employer. *Matthews* at 982.

## **B. Reasonableness Requirements**

In Oklahoma, covenants not to compete must be reasonable in terms of time and territorial limitations in light of the legitimate interests the employers seeks to protect. See *Mammana* at 214 (covenant that effectively prevented doctor from practicing within 100 mile radius of Tulsa unenforceable even though the covenant only stated that it applied to a twenty mile radius). Whether a covenant not to compete is reasonable is determined by the courts on a case-by-case basis after analyzing all the facts and circumstances of the individual case. *Matthews* at 980. There is no general presumption regarding what time period is reasonable. For instance, a time limitation of nine months has been held to be reasonable. *Key Temp. Personnel* at 1214. A time limitation of two years has also been held to be reasonable. *Thayne A. Hedges Reg'l Speech & Hearing Ctr., Inc. v. Baughman*, 996 P.2d 939, 941 (Okla. Ct. App. 1998). However, a time limitation of three years has been held void and unenforceable. *Matthews* at 979. Not surprisingly, a ten year restriction with no particular geographic limitation was also held unenforceable. *Cohen Realty v. Marinick*, 817 P.2d 747, 749 (Okla. Ct. App. 1991).

In general, Oklahoma courts seem most concerned with whether the restriction relates to active solicitation of the employer's customers (which will generally be upheld) or some other type of activity. For instance, in *Mammana*, the court held unenforceable a nine month bar on solicitation, diversion *or acceptance* of referrals from the employer's referral service. *Mammana* at 214. The court found that the restriction was too broad because it would have prohibited the employee from accepting referrals that he did not actively seek. *Id.* Conversely, the court upheld a one year restriction on active solicitation of the employer's patients by the employee because it allowed an exception for patients who affirmatively requested the former employee's services. *Id.*

## **C. Consideration**

Pursuant to statute, consideration will be presumed anytime there is a written instrument. OKLA. STAT. ANN. tit. 15, § 115.

## **VII. ADDITIONAL COMMENTS**

## A. Court Reformation

If a restrictive covenant is overbroad, it can be equitably modified if the contractual defect can be cured by imposing reasonable limitations concerning the activities embraced, time, or geographical limitations. *Mammana* at 213; *Bayly* at 1173. Although Oklahoma courts have the power to modify an unreasonable restraint on trade, they do not always exercise the power, and they will refuse to supply material terms of a contract. *Mammana* at 213; *Bayly* at 1172-73. See also *Herchman v. Sun Medical, Inc.*, 751 F. Supp. 942, 947 (N.D. Okla. 1990); *Marinick* at 749 (stating that court cannot modify covenant “if the essential elements of the contract must be supplied”).

## B. Enforceability if Employee Terminated

Oklahoma courts have not expressly addressed this issue.

In *Marinick*, the employee was terminated after two years of employment. The parties entered into a termination agreement that expressly stated that the non-compete covenant in the employment agreement would remain in effect after termination. The court simply noted this fact but did not discuss if it would have made any difference had such an explicit termination agreement not been signed. See *Marinick* at 748. Perhaps the court did not address the issue because it found the covenant was unenforceable because it was too broad—it was ten years with no discernable geographic or scope of activity limitations. *Id.* at 749.

In *Key Temporary Personnel*, the employee argued that the covenant not to compete should not be enforced against her essentially on a theory that she was constructively discharged. See *Key Temp. Personnel* at 1217. The court held that, bottom line, she was the one that terminated the employment relationship; and because of that, the reasons surrounding the termination of the employment relationship were not relevant to determining whether the covenant was reasonable. *Id.* (holding however that they are relevant, perhaps, to whether a preliminary injunction to enforce the covenant was proper). Finally, the court distinguished the case authority the employee relied on, noting that here, the employee had not been terminated by the employer, and the covenant explicitly stated that it applied regardless of why the employment relationship ended. *Id.* at 1217 n. 6. However, the court never discussed whether the case would have been different had the employee actually been terminated or if the covenant did not contain such an explicit expression that it would apply regardless of how the employment relationship ended.

### **C. Choice of Law Provisions**

With respect to contract actions, “a choice-of-law clause is unenforceable if its application violates the law or public policy of Oklahoma as expressed in the state's constitution, statutes, or case law.” *MidAmerica Constr. Mgmt., Inc. v. Mastec N. Am., Inc.*, 436 F.3d 1257, 1260 (10th Cir. 2006). Choice of law provisions may be included in covenants not to compete, and the Oklahoma courts will apply the law of the state chosen, unless the parties' choice of law “violate[s] the provisions of Oklahoma law with respect to contracts in restraint of trade.” *Oliver v. Omnicare, Inc.*, 103 P.3d 626, 628 (Okla. Civ. App. 2004) To answer this question, courts will examine the reasonableness of the covenant under the law of the chosen state, and under Oklahoma's law, and compare the two outcomes. *Eakle v. Grinnell Corp.*, 272 F. Supp. 2d 1304, 1312 (E.D. Okla. 2003). If the differences are not great, the court will likely not find Oklahoma's public policy to be implicated, and will apply the chosen state's law. Compare *Id.* at 1313 (two-state territorial restriction with Delaware choice of law upheld) with *Southwest Stainless, L.P. v. Sappington*, 2008 WL 918706 (N.D. Okla. 2008) (seven-state territorial restriction with Florida choice of law stuck down).

### **D. Sale of Business**

This is governed by § 218 of the generally applicable statute. To that extent, the analysis is essentially the same. However, because the sale of a business is one of the explicitly recognized statutory “exceptions,” Oklahoma courts may be willing to uphold greater restrictions. Compare *Eakle* at 1304 (upholding five year restraint covering Arkansas and Oklahoma—court analyzed under Delaware and Oklahoma law and found even though geographic restriction probably invalid under Oklahoma law, it was not enough to implicate state's public policy and override choice of law provision); *Farren v. Autoviable Servs., Inc.*, 508 P.2d 646, 649 (Okla. 1973) (one year restraint on participating in competing business in same territory enforceable) and *Griffin v. Hunt*, 268 P.2d 874, 877 (Okla. 1954) (five year restraint in county of previous dental practice enforceable) with *Southwest Stainless, L.P. v. Sappington*, 2008 WL 918706 (N.D. Okla. 2008) (voiding a three-year, seven-state territorial restriction involving the sale of a business).

### **E. Forfeiture Provisions**

A forfeiture of benefits provision generally is treated as a restraint of trade and thus will be subject to the same analysis as other noncompetition covenants. *Graham v. Hudgins, Thompson, Ball and*

*Assoc. Inc.*, 540 P.2d 1161, 1163 (Okla. 1975). In fact, it will be analyzed under the same statutory framework. *Id.* (court held provision that called for forfeiture of funds in employee benefit plan upon accepting employment with a competitor was an invalid restraint under § 217). If the benefits fall under the control of ERISA, however, then state law regarding covenants not to compete is preempted. *Loffland Bros. v. Overstreet*, 758 P.2d 813, 817 (Okla. 1988).

## OREGON

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## OREGON

### I. Judicial Statement of the Law

Post-employment covenants not to compete entered into in the employment context are governed by Or. Rev. Stat. § 653.295.

**Covenants Entered Into On or After January 1, 2008:** In 2007, the Oregon legislature significantly amended the state's noncompete statute. Under the amended Or. Rev. Stat. § 653.295, a covenant not to compete in the employment context entered into on or after January 1, 2008 is voidable and unenforceable unless:

- The employer tells the employee in a written job offer at least *two weeks before* the employee starts work that the noncompete is required, or the noncompete is entered into upon a “bona fide advancement”; and
- The employee is exempt from Oregon minimum wage and overtime laws; and
- The employer has a “protectable interest” (access to trade secrets or competitively sensitive confidential information); and
- The employee's annual gross salary is more than the median family income for a family of four as calculated by the Census Bureau.

Even if the employee is not exempt and does not meet the salary test, an employer can still obtain an enforceable post-employment covenant not to compete if, during the period the employee is restricted from working for a competitor, the employer pays the departed employee 50 percent of the employee's salary or 50 percent of the median family income for a family of four, whichever is greater.

Or. Rev. Stat. § 653.295 (2007) provides:

#### **653.295. Noncompetition agreements; bonus restriction agreements; applicability of restrictions.**

- A.** A noncompetition agreement entered into between an employer and employee is voidable and may not be enforced by a court of this state unless:
1. The employer informs the employee in a written employment offer received by the employee at least two weeks before the first day of the employee's employment that a noncompetition agreement is required as a condition of employment; or

2. The noncompetition agreement is entered into upon a subsequent bona fide advancement of the employee by the employer;
3. The employee is a person described in ORS 653.020 (3);
4. The employer has a protectable interest. As used in this paragraph, an employer has a protectable interest when the employee:
  - B.** Has access to trade secrets, as that term is defined in ORS 646.461;
  - C.** Has access to competitively sensitive confidential business or professional information that otherwise would not qualify as a trade secret, including product development plans, product launch plans, marketing strategy or sales plans; or
  - D.** Is employed as an on-air talent by an employer in the business of broadcasting and the employer:
    1. In the year preceding the termination of the employee's employment, expended resources equal to or exceeding 10 percent of the employee's annual salary to develop, improve, train or publicly promote the employee, provided that the resources expended by the employer were expended on media that the employer does not own or control; and
    2. Provides the employee, for the time the employee is restricted from working, the greater of compensation equal to at least 50 percent of the employee's annual gross base salary and commissions at the time of the employee's termination or 50 percent of the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination; and
    3. The total amount of the employee's annual gross salary and commissions, calculated on an annual basis, at the time of the employee's termination exceeds the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination. This paragraph does not apply to an employee described in paragraph (c)(C) of this subsection.
- E.** The term of a noncompetition agreement may not exceed two years from the date of the employee's termination. The remainder of a term of a noncompetition agreement in excess of two years is voidable and may not be enforced by a court of this state.

- F.** Subsections (1) and (2) of this section apply only to noncompetition agreements made in the context of an employment relationship or contract and not otherwise.
- G.** Subsections (1) and (2) of this section do not apply to:
1. Bonus restriction agreements, which are lawful agreements that may be enforced by the courts in this state; or
  2. A covenant not to solicit employees of the employer or solicit or transact business with customers of the employer.
- H.** Nothing in this section restricts the right of any person to protect trade secrets or other proprietary information by injunction or any other lawful means under other applicable laws.
- I.** Notwithstanding subsection (1)(b) and (d) of this section, a noncompetition agreement is enforceable for the full term of the agreement, for up to two years, if the employer provides the employee, for the time the employee is restricted from working, the greater of:
1. Compensation equal to at least 50 percent of the employee's annual gross base salary and commissions at the time of the employee's termination; or
  2. Fifty percent of the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination.
- J.** As used in this section:
1. "Bonus restriction agreement" means an agreement, written or oral, express or implied, between an employer and employee under which:
  2. Competition by the employee with the employer is limited or restrained after termination of employment, but the restraint is limited to a period of time, a geographic area and specified activities, all of which are reasonable in relation to the services described in subparagraph (B) of this paragraph;
  3. The services performed by the employee pursuant to the agreement include substantial involvement in management of the employer's business, personal contact with customers, knowledge of customer requirements related to the employer's business or

knowledge of trade secrets or other proprietary information of the employer; and

4. The penalty imposed on the employee for competition against the employer is limited to forfeiture of profit sharing or other bonus compensation that has not yet been paid to the employee.
- K.** "Broadcasting" means the activity of transmitting of any one-way electronic signal by radio waves, microwaves, wires, coaxial cables, wave guides or other conduits of communications.
- L.** "Employee" and "employer" have the meanings given those terms in ORS 652.310.(d) "Noncompetition agreement" means an agreement, written or oral, express or implied, between an employer and employee under which the employee agrees that the employee, either alone or as an employee of another person, will not compete with the employer in providing products, processes or services that are similar to the employer's products, processes or services for a period of time or within a specified geographic area after termination of employment.

Or. Rev. Stat. § 653.295 (2007).

**Covenants Entered Into Before January 1, 2008:** Covenants executed *prior to* January 1, 2008 are governed by Or. Rev. Stat. § 653.295 (2005), which provides that a covenant not to compete is void and unenforceable unless the agreement is entered into upon the:

- (a) Initial employment of the employee with the employer; or
- (b) Subsequent bona fide advancement of the employee with the employer.

Notably, the statute prior to the 2007 amendment does not require employers to notify prospective employees in writing 2 weeks before the first day of employment that execution of a covenant not to compete is a condition of employment.

## **II. PARAMETERS OF THE "REASONABLENESS" TEST**

### **A. Ancillary to an employment contract:**

"A non-competition provision in an employment contract is a covenant in restraint of trade.

Three things are essential to the validity of a contract in restraint of trade[:]  
(1) it must be partial or restricted in its operation in respect either to time

or place; (2) it must come on good consideration; and (3) it must be reasonable, that is, it should afford only a fair protection to the interests of the party in whose favor it is made, and must not be so large in its operation as to interfere with the interests of the public.”

*Volt Services Group v. Adecco Employment Services, Inc.*, 178 Or. App. 121, 126, 35 P.3d 329 (2001) (internal citations omitted).

The absence of both a geographical and temporal limitation does not make the covenant void as a matter of law; reasonable limitations will be implied, if possible. *Kelite Products, Inc. v. Brandt*, 206 Or. 636, 654-655, 294 P.2d 320(1956); *Lavey v. Edwards*, 264 Or. 331, 334-335, 505 P.2d 342 (1973).

**B. Ancillary to the sale of a business:**

The absence of both a geographical and temporal limitation does not make the covenant void as a matter of law; reasonable limitations will be implied, if possible. *Renzema v. Nichols*, 83 Or. App. 322, 323, 731 P.2d 1048 (1987) (covenant between competitors).

**III. GENERAL COMMENTS**

**A. Protectable interests:**

1. The employer has a protectable interest when the employee has access to (1) trade secrets; or (2) “competitively sensitive confidential business or professional information that otherwise would not qualify as a trade secret, including product development plans, product launch plans, marketing strategy or sales plans.” Or. Rev. Stat. § 653.295(1)(c).
2. General knowledge acquired through training and experience is generally not a protectable interest for purposes of restrictive covenants. *See Rem Metals Corp. v. Logan*, 278 Or. 715, 720-21, 565 P.2d 1080 (1977) (That fact that “general knowledge, skill, or facility acquired through training or experience” were acquired or developed during the employment “does not, by itself, give the employer a sufficient interest to support a restraining covenant, even though the on-the-job training has been extensive and costly.”); *Nike, Inc. v. McCarthy*, 379 F.3d 576, 585 (9th Cir. 2004) (finding that a regional sales manager’s general skills in sales and product development and his industry knowledge acquired during his employment did not constitute protectable interest of the employer to justify enforcement of a noncompete agreement).

3. However, an employer has a protectable interest in “information pertaining especially to the employer’s business.” *Nike, Inc. v. McCarthy*, 379 F.3d 576, 585 (9th Cir. 2004).

“Contacts between an employer’s employees and its customers can create a protectable interest when the nature of the contact is such that there is a substantial risk that the employee may be able to divert all or part of the customer’s business.” *Volt Service Group v. Adecco Employment Services, Inc.*, 178 Or. App. 121, 126-127, 35 P.3d 329 (2001). The extent to which the employee is likely to be identified in the customer’s mind with the employer’s product or service determines whether the risk of customer diversion is “sufficiently great to warrant a restriction, and how broad a restriction will be permitted.” *Id.* at 127. See also *Cascade Exch., Inc. v. Reed*, 278 Or. 749, 565 P.2d 1095 (1977) (enforcing a noncompete agreement when “the employees’ work necessarily involved access to plaintiff’s customer lists, as well as some other specialized information relating to customers, and employees” and “had frequent and close contacts with plaintiff’s customers on a personal basis”); *North Pacific Lumber Co. v. Moore*, 275 Or. 359, 551 P.2d 431 (1976) (upholding a noncompete agreement where the employee had accumulated information about “the type of lumber which filled the special needs of the various buyers”); *Kelite Prods., Inc. v. Brandt*, 206 Or. 636, 294 P.2d 320 (1956) (affirming lower court’s injunction restraining employees from soliciting or selling to customers of the former employer where the employees had access to customer lists that showed the dates of purchases made by such customers and the types of products purchased).

Confidential and valuable proprietary marketing and product information constitutes a protectable interest. *Nike, Inc. v. McCarthy*, 379 F.3d 576, 586 (9th Cir. 2004) (A regional sales manager’s job duties gave him access to valuable proprietary marketing and product information, which justified enforcement of a 1-year covenant not to compete. The court found that it was not necessary to show that the employee actually used any confidential information in his new position for the information to constitute a protectable interest).

- B. Employee and customer non-solicitation provisions:** Provisions prohibiting solicitation of customers or employees are treated in the same way as noncompetition agreements. *First AllAmerica Financial Life Insurance. Co. v. Sumner*, 212 F. Supp. 2d 1235, 1238-1239 (D. Or. 2002).

**C. Terminating employee for refusing to sign noncompete:** Or. Rev. Stat. § 653.295 does not prohibit employers from terminating an employee for refusing to sign a noncompetition agreement. *Dymock v. Norwest Safety Protective Equipment for Oregon Industry, Inc.*, 334 Or. 55, 59-60, 45 P.3d 114 (2002) (holding that plaintiff failed to state a claim for wrongful discharge for refusing to sign a noncompete at times other than those that the statute permits because “[n]othing in the statute confers a right to refuse to sign such agreements”).

**D. Blue pencil/modification:** Courts can modify an overly broad covenant, and even provide a reasonable limit if no time or geographic limitation was provided in the covenant. *Lavey v. Edwards*, 264 Or. 331, 334-35, 505 P.2d 342 (1973).

**E. Consideration:**

1. A restrictive covenant signed at the inception of employment provides sufficient consideration so long as the employer can demonstrate a legitimate protectable interest. Or. Rev. Stat. §653.295(1)(a); *McCombs v. McClelland*, 223 Or. 475, 480, 354 P.2d 311, 314 (1960). The covenant must be signed at the time the employment commences, with no more than a *de minimus* delay before employment begins. *Konecranes, Inc. v. Sinclair*, 340 F. Supp. 2d 1126, 1129 (D. Or. 2004) (16 day delay in signing noncompete too long); see also *Ikon Office Solutions, Inc. v. American Office Products, Inc.*, 178 F. Supp.2d 1154, 1159-61 (D. Or. 2001) (finding no Oregon decision enforcing noncompete agreement signed more than 3 days after employee commenced work, and holding that 17 days was too long an interval); *Perthou v. Stewart*, 243 F. Supp. 655, 659 (D. Or. 1965) (6 day delay too long); *Miller v. Kroger Co.*, 2001 U.S. Dist. LEXIS 25626 (D. Or. 2001) (7-week delay too long).

2. A “bona fide advancement of the employee with the employer” is sufficient consideration to support a covenant not to compete entered into after the employment relationship has begun. Or. Rev. Stat. §653.295(1)(b). A “bona fide advancement” requires an actual change in the employee’s job status or duties performed, and not merely a raise in salary, an improved benefit package, or some other form of additional compensation. *First Allmerica Fin. Life Ins. Co. v. Sumner*, 212 F. Supp. 2d 1235, 1241 (D. Or. 2002).

In determining the date that a “bona fide advancement” occurs, courts will consider the following factors: (1) the date the offer was made and whether the offer was expressly contingent upon any

other factors; (2) the date of acceptance and whether acceptance was contingent upon any other factors; (3) the company's standard practices and procedures relative to promotions; (4) a title change; (5) an enhancement in job duties and responsibilities; and (6) an enhancement in pay and/or the benefits package. *Nike, Inc. v. McCarthy*, 285 F. Supp. 2d 1242, 1246 (D. Or. 2003), affirmed by *Nike, Inc. v. McCarthy*, 379 F.3d 576, 583-84 (9th Cir. 2004) (finding that the "bona fide advancement" requirement ordinarily includes "new, more responsible duties, different reporting relationships, a change in title and higher pay").

Whether a covenant is "entered into upon" the advancement depends on the totality of the circumstances. "[A]lthough a non-compete agreement need not be entered into at the first instance that the employee assumes any elements of the new job, including new duties, neither does the window of opportunity to ask for a noncompete agreement remain open until the employer sees fit formally to finalize the advancement process." *Nike, Inc. v. McCarthy*, 379 F.3d 576, 584 (9th Cir. 2004) (holding that the covenant was entered into upon a bona fide advancement where it was signed by the employee within 5 days of the final agreement on the new job's terms and conditions, and because the employer had not unreasonably delayed finalizing the process).

- F. Enforceability of "clawbacks" and other forfeitures of benefits:** "The validity of forfeiture clauses in pension plans "should be determined in much the same way that the validity or invalidity of a noncompetition clause in an employment contract is determined, i.e., by the test of reasonableness-whether the clause is an unreasonable restraint of trade." *Lavey v. Edwards*, 264 Or. 331, 337, 505 P.2d 342 (1973). Continued employment is sufficient consideration to support a bonus restriction agreement under which the penalty imposed is limited to forfeiture of bonus compensation, such as profit sharing, that has not yet been paid to the employee. Or. Rev. Stat. § 653.295(4).
- G. Assignability:** Noncompetition agreements are not assignable under Oregon law. *Perthou v. Stewart*, 243 F. Supp. 655, 659 (D. Or. 1965).
- H. Is a noncompete covenant enforceable if the employee is discharged?** Yes. *Nike, Inc. v. McCarthy*, 285 F. Supp. 2d 1242, 1246 (D. Or. 2003) (The fact that the employee was terminated by the company "bears no direct relation to the validity of the contract". The court found that "nothing in the terms of the contract invalidates its provisions based upon the voluntary or involuntary nature of the [employee's] separation from the company.").

- I. Will employer’s breach of employment agreement relieve the employee of his obligation not to compete? This issue has not yet been decided in Oregon.
- J. **Will a choice of law provision in a contract be followed?** Probably not unless the covenant complies with Or. Rev. Stat. § 653.295. Oregon has “an unequivocal statement of public policy” voiding any covenant not to compete that does not meet the requirements of the state’s noncompetition statute. *Konecranes, Inc. v. Sinclair*, 340 F. Supp. 2d 1126, 1130 (D. Or. 2004) (finding that Oregon’s interests were sufficient to apply its own state laws despite an Ohio choice of law provision in the covenant where the employee was a resident of Oregon, was employed there, and was attempting to compete there, and because the agreement was not negotiated between two businesses or an independent contractor with greater who may have greater leeway to establish their own terms).
- K. **Attorneys’ fees:** Where an attorney-fees provision provided for “cost of pursuing legal action to enforce” the noncompetition agreement, the fee provision “was legally viable only if the noncompetition agreement was enforced.” *Care Med. Equip., Inc. v. Baldwin*, 331 Or. 413, 419, 15 P.3d 561 (2000) (holding that “[o]nce the court determined that the noncompetition provision of the contract was void, no provision of the parties’ contract permitted defendant to claim attorney fees.”).
- L. **Trade secrets defined:** Oregon has adopted the Uniform Trade Secrets Act. Or. Rev. State §§ 646.461 to 646.475.
- M. **Noteworthy articles:** Leonard D. DuBoff & Christy O. King, Legal Practice Tips: A New Wrinkle: Non-Competition Agreements in Oregon, 67 Or. St. B. Bull. 36 (Aug.-Sept. 2007) (examining 2007 amendments to the noncompetition statute, Or. Rev. State § 653.295).

## PENNSYLVANIA

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## PENNSYLVANIA

### I. JUDICIAL STATEMENT OF THE LAW

"[Pennsylvania] courts will permit the equitable enforcement of post-employment restraints only where they are incident to an employment relationship between the parties to the covenant, the restrictions are reasonably necessary for the protection of the employer, and the restrictions are reasonably limited in duration and geographic extent." *Sidco Paper Co. v. Aaron*, 351 A.2d 250, 252 (Pa. 1976). See also *New Castle Orthopedic Assocs. v. Burns*, 392 A.2d 1383, 1387 (Pa. 1978) (where the court also looked to societal interests).

"In determining whether to enforce a non-competition covenant, this Court requires the application of a balancing test whereby the court balances the employer's protectible business interests against the interest of the employee in earning a living in his or her chosen profession, trade or occupation, and then balances the result against the interest of the public." *Hess v. Gebhard & Co., Inc.*, 808 A.2d 912, 920 (Pa. 2002).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract

1. *Hess v. Gebhard & Co., Inc.*, 808 A.2d 912, 920 (Pa. 2002) (covenants not to compete ancillary to employment will be subjected to a more stringent test of reasonableness than that applied to covenants ancillary to the sale of a business).
2. *John G. Bryant Co., Inc. v. Sling Testing & Repair, Inc.*, 369 A.2d 1164 (Pa. 1977) (three-year, three-state, no former-customers restriction on salesmen was reasonable); *Blair Design & Constr. Co., Inc. v. Kalimon*, 530 A.2d 1357 (Pa. Super. Ct. 1987) (three-year restriction on contacting customers on list was enforceable); *Records Center, Inc. v. Comprehensive Mgmt., Inc.*, 525 A.2d 433 (Pa. Super. Ct. 1987) (one-year covenant restricting solicitation of former employer's clients within a five-state territory was reasonable); *Robert Clifton Assocs., Inc. v. O'Connor*, 487 A.2d 947 (Pa. Super. Ct. 1985) (one-year, 75-mile restriction on former employment agency specialist was reasonable).
3. *Sidco Paper Co. v. Aaron*, 351 A.2d 250 (Pa. 1976) (court enforced two-year covenant after limiting the geographical restriction to the four-state region that the salesman had formerly covered for the employer); *Reading Aviation Serv., Inc. v. Bertolet*, 311 A.2d 628 (Pa. 1973) (court refused to enforce covenant which attempted to

restrict former president of plaintiff corporation from assisting in a competing business because it lacked time and area limitations); *WellSpan Health v. Bayliss*, 869 A.2d 990, 1001 (Pa. Super. Ct. 2005) (court refused to enforce covenant in geographic area where former employer did not compete).

## **B. Incidental to the sale of a business**

1. "Post-employment restrictive covenants are subject to a more stringent test of reasonableness than such covenants ancillary to the sale of a business." *Thermo-Guard, Inc. v. Cochran*, 596 A.2d 188, 194 (Pa. Super. Ct. 1991) (citing *Morgan's Home Equip. Corp. v. Martucci*, 136 A.2d 838 (Pa. 1957)); see also *Geisinger Clinic v. DiCuccio*, 606 A.2d 509, 518 (Pa. Super. Ct. 1992); *Worldwide Auditing Services, Inc. v. Richter*, 587 A.2d 772, 776 (Pa. Super. Ct. 1991) (a reasonable restrictive covenant ancillary to the sale of stock is enforceable); *Sobers v. Shannon Optical Co., Inc.*, 473 A.2d 1035 (Pa. Super. Ct. 1984) (eight-county, five-year restriction was enforceable); *Ross v. Houck*, 136 A.2d 160 (Pa. Super. Ct. 1957) (five-year, three-mile restrictive covenant reasonable).
2. *Westec Sec. Servs., Inc. v. Westinghouse Elec. Corp.*, 538 F. Supp. 108 (E.D. Pa. 1982) (twenty-year restriction on marketing home security systems was reduced to ten years).

## **III. GENERAL COMMENTS**

- A.** Protectable interests: The employer's relationship with its customers, confidential information and trade secrets, unique or extraordinary skills, and investments in an employee specialized training program. *John G. Bryant Co., Inc. v. Sling Testing & Repair, Inc.*, 369 A.2d 1164 (Pa. 1977); *Morgan's Home Equip. Corp. v. Martucci*, 136 A.2d 838, 846 (Pa. 1957). See also *WellSpan Health v. Bayliss*, 869 A.2d 990, 996-99 (Pa. Super. Ct. 2005) (summarizing recognized protectable interests and concluding that healthcare provider's patient referral base was protectable); *Thermo-Guard, Inc. v. Cochran*, 596 A.2d 188, 193 (Pa. Super. Ct. 1991) (goodwill); *Blair Design & Constr. Co., Inc. v. Kalimon*, 530 A.2d 1357 (Pa. Super. Ct. 1987) (client lists).
- B.** A non-competition covenant applied to a geographical area where the former employer does not compete is unreasonable. *WellSpan Health v. Bayliss*, 869 A.2d 990, 1001 (Pa. Super. Ct. 2005) (refusing to enforce covenant in county where former employer did not compete).

- C.** If a covenant is overbroad, but does not indicate "an intent to oppress the employee and/or to foster a monopoly," it may be equitably modified and enforced to the extent reasonably necessary for the protection of the employer. *Sidco Paper Co. v. Aaron*, 351 A.2d 250, 256-57 (Pa. 1976). See also *Hess v. Gebhard & Co., Inc.*, 808 A.2d 912, 920 (Pa. 2002); *WellSpan Health v. Bayliss*, 869 A.2d 990, 996 n.2 (Pa. Super. Ct. 2005) ("It is well-established in Pennsylvania that a court of equity has the authority to reform a non-competition covenant in order to enforce only those provisions that are reasonably necessary for the protection of the employer."); *Davis & Warde, Inc. v. Tripodi*, 616 A.2d 1384, 1388 (Pa. Super. Ct. 1992).
- D.** Continued employment is not sufficient consideration for a noncompetition agreement. *George W. Kistler, Inc. v. O'Brien*, 347 A.2d 311, 316 (Pa. 1975). However, a change in the conditions of the employment contract, such as a change in benefits or a change in status, can qualify as sufficient consideration. *Maint. Specialties, Inc. v. Gottus*, 314 A.2d 279, 281-83 (Pa. 1974).
- E.** A forfeiture of benefits provision is treated as a restraint of trade, and therefore is subject to the same type of analysis. See, e.g., *Garner v. Girard Trust Bank*, 275 A.2d 359 (Pa. 1971) (two-year noncompetition clause upheld and pensions forfeited); *Bilec v. Auburn & Assocs., Inc. Pension Trust*, 588 A.2d 538, 543 (Pa. Super. Ct. 1991) (the noncompetition clause was void because it contained no time limitation, and thus the pensions were not forfeited); see also *Fraser v. Nationwide Mutual Ins. Co.*, 334 F. Supp. 2d 755, 758, 761 (E.D. Pa. 2004) (considering general standards for enforceability of non-compete agreements from *Hess v. Gebhard & Co., Inc.*, 808 A.2d 912 (Pa. 2002), in enforcing provision forfeiting deferred compensation for competing within 25 miles and one year of leaving former employer).
- F.** Restrictive covenants not to compete contained in employment agreements are not assignable in the absence of a specific assignability provision, where the covenant is included in the sale of the business assets. *Hess v. Gebhard & Co., Inc.*, 808 A.2d 912, 922 (Pa. 2002); *Savage, Sharkey, Reiser & Szulborski Eye Care Consultants, P.C. v. Tanner*, 848 A.2d 150, 154-58 (Pa. Super. Ct. 2004) (finding employment contract with non-compete agreement assignable pursuant to assignability provision, but refusing to enforce non-compete provision because employer failed to provide employee with written notice of assignment as required by contract).
- G.** Is a noncompete covenant enforceable if the employee is discharged? It depends. Where the employee is wrongfully discharged, the employer

cannot enforce the covenant. See *Ritz v. Music, Inc.*, 150 A.2d 160, 162 (Pa. Super. Ct. 1959).

- H.** Will employer's prior material breach of the employment agreement relieve the employee of his obligation not to compete? Yes. See *Ritz v. Music, Inc.*, 150 A.2d 160 (Pa. Super. Ct. 1959).
- I.** Will a choice of law provision in a contract be followed? Yes, subject to the limitations set forth in the Restatement (Second) of Conflict of Laws § 187(2). See, e.g., *Shifano v. Shifano*, 471 A.2d 839, 843 (Pa. Super. Ct. 1984); *Aluminum Co. of Am. v. Essex Group, Inc.*, 499 F. Supp. 53, 59 (W.D. Pa. 1980).
- J.** Trade secrets defined: 12 Pa. C.S. § 5302 (2004).
- K.** Equity will protect an employer from disclosure of trade secrets by a former employee provided the employee entered into an enforcement covenant restricting their use or the duty of secrecy was implied by virtue of a confidential relationship. *Wexler v. Greenberg*, 160 A.2d 430, 434-35 (Pa. 1960); see also *Fralich v. Despar*, 30 A. 521 (Pa. 1894). However, a former employee may “take with him” the experience, knowledge, memory, and skill gained from the former employer. *Van Prods. Co. v. Gen. Welding & Fabricating Co.*, 213 A.2d 769, 776 (Pa. 1965).
- L.** Noteworthy articles and/or publications: Angela M. Cerino, A Talent is a Terrible Thing to Waste: Toward a Workable Solution to the Problem of Restrictive Covenants on Employment Contracts, 24 Duq. L. Rev. 777-810 (1986); Case Comment, Enforcement of Restrictive Covenants in Pennsylvania Employment Contracts, 80 Dick. L. Rev. 693 (1976).
- M.** Noteworthy case summarizing scope of permissible/impermissible restraints: *Davis & Warde, Inc. v. Tripodi*, 616 A.2d 1384 (Pa. Super. Ct. 1992).

## RHODE ISLAND

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## RHODE ISLAND

### I. SUMMARY OF THE LAW

In order to be enforceable, a noncompetition covenant must not only be legally valid and supported by adequate consideration, but it must also reasonable and necessary for the protection of those in whose favor it is made. Reasonableness is determined by the limitations on both time and geographic space contained in the agreement. The test applied is whether the "restrictions under the conditions of each case" are reasonable. Reasonableness of an agreement is "determined by its subject matter and the conditions under which it was made; by considerations of extensiveness or localism, of protection to interests sold and paid for, of mere deprivation of public rights for private gain, of proper advantage on one side or useless oppression on the other."

Before a court reaches the question of reasonableness, the party seeking to enforce the covenant must show that (1) the provision is ancillary to an otherwise valid transaction or relationship, (2) the provision is supported by consideration, and (3) there exists a legitimate interest that the provision is designed to protect.

*Durapin, Inc. v. American Products, Inc.*, 559 A.2d 1051 (R.I. 1989); *Oakdale Manuf. Co. v. Garst*, 28 A. 973 (R.I. 1895).

A non-compete covenant that is part of a settlement agreement, rather than an employment contract or a contract for the sale of a business, is nevertheless ancillary to a valid transaction, and may be enforced so long as it meets the general requirements for enforceability. *Cranston Print Works Co. v. Pothier*, 848 A.2d 213 (R.I. 2004).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Covenants Held Reasonable.* *Nestle Food Co. v. Miller*, 836 F. Supp. 69 (D.R.I. 1993) (one-year prohibition on selling for a direct competitor is reasonable and enforceable); *Block v. Vector of Warwick, LLC*, 2000 WL 1634784 (R.I. Super. 2000) (Two-year, ten-mile restriction on practice of veterinary medicine upheld as reasonable. The court noted that "a covenant not to compete should last no longer than necessary for the employees' replacements to have a reasonable opportunity to demonstrate their effectiveness to customers"); *R.J. Carbone Co. v. Regan*, 2008 U.S. Dist. LEXIS 81996 (one-year, 100 mile prohibition on competing with former employer held reasonable as to time, but unreasonable as to geographic scope).

2. *Covenants Held Unreasonable. Durapin, Inc. v. American Products*, 559 A.2d 1051 (R.I. 1989) (three-year, total market restraint unreasonable); *Max Garelick, Inc. v. Leonardo*, 250 A.2d 354 (R.I. 1969) (five-year restraint on purchasing grain from previous supplier of plaintiff unreasonable and unenforceable).

**B. Incidental to the sale of a business.**

1. *Covenants Held Reasonable. French v. Parker*, 14 A. 870 (R.I. 1888) (unlimited time restraint on physician practicing in same city found reasonable); *In re Givens*, 251 B.R. 11 (D.R.I. 2000) (approving a worldwide, six-year restriction against inventor of life raft and president of company in connection with the sale of assets of a life raft manufacturer. Original covenant not to compete was unlimited in time and in geographic scope, and it was reduced to a six-year time period by the court);
2. *Covenants Held Unreasonable. Mento v. Lanni*, 262 A.2d 839, 842 (R.I. 1970) (unlimited time, two-mile restraint on opening barber shop found unreasonable).

**III. GENERAL COMMENTS**

- A. Protectible interests:** Sale of good will, trade secrets and other confidential information, confidential customer lists, customer contacts; *See Mento v. Lanni*, 262 A.2d 839, 841 (R.I. 1970); *Durapin Inc. v. American Products, Inc.*, 559 A.2d 1051 (R.I. 1989); *Callahan v. Rhode Island Oil Co.*, 240 A.2d 411, 413 (R.I. 1968). *See also Rego Displays, Inc. v. Fournier*, 379 A.2d 1098, 1101 (1977) (special relationship with customers); *Nestle Food Co. v. Miller*, 836 F. Supp. 69 (D.R.I. 1993) (confidential customer lists, special relationships with customers). The court will recognize a protectible interest in customer lists only if the list is confidential in nature, or if a special relationship is formed between the former employee and the customers due to the employee's knowledge of the customer's specific and otherwise unknown needs. *Durapin, Inc. v. American Products, Inc.*, 559 A.2d 1051 (R.I. 1989).
- B. Covenant reformation:** If covenant is overbroad, it can be modified and enforced to the extent it is reasonably necessary without imposing undue hardship on promisor or adversely affecting the public interest, unless the circumstances indicate bad faith or deliberate overreaching on the part of the employer. *Durapin, Inc. v. American Products, Inc.*, 559 A.2d 1051, 1058 (R.I. 1989). Covenants may be modified whether or not their terms are divisible. Id.

- C. Consideration:** The case law in Rhode Island has not specifically addressed whether continued employment is sufficient consideration to support a covenant not to compete. A sister federal court in Rhode Island, attempting to anticipate how the Rhode Island courts would rule on the issue, found that continued employment is sufficient consideration. *Nestle Food Co. v. Miller*, 836 F. Supp. 69 (D.R.I. 1993), 77 & n.32.
- D. Forfeiture of benefits:** A forfeiture of benefits provision would probably be treated as a restraint of trade and thus be subject to the same analysis as other non-competition covenants. See *Durapin, Inc. v American Products, Inc.*, 559 A.2d 1051, 1056 (R.I. 1989) (court expressly declined to rule on the enforceability of a forfeiture condition but "saw very little difference between" them).
- E. Attorneys' fees:** Attorneys' fees are not recoverable absent specific statutory authority or contract. *R.A. Beaufort & Sons, Inc. v. Trivisonno*, 403 A.2d 664, 668 (1979). Under the Rhode Island Uniform Trade Secrets Act, the court may award reasonable attorneys' fees to the prevailing party if a claim of misappropriation of trade secrets is made in bad faith, a motion to terminate an injunction is made or resisted in bad faith, or willful and malicious misappropriation exists. R.I. Gen. Laws 1956, §6-41-4.
- F. Choice of law:** Rhode Island will enforce choice of law provisions contained in contracts, so long as the jurisdiction selected has a "real relation to the contract." *Carcieri v. Creative Servs.*, 1992 R.I. Super. LEXIS 25 (citing *Owens v. Hagenbeck-Wallace Shows Co.*, 58 R.I. 162 (1937)). Where the contract does not contain a choice of law provision, Rhode Island courts will apply the "interest weighing" test to determine which state has the more significant interest in the resolution of the issues presented in the case, and will also consider as a factor the place of contract. *R.J. Carbone v. Regan*, 2008 U.S. Dist. Ct. LEXIS 81996 (R.I. 2008). Under the interest weighing test, the court considers the following factors: (1) predictability of result; (2) maintenance of interstate and international order; (3) simplification of the judicial task; (4) advancement of the forum's governmental interests; and (5) application of the better rule of law. *Id.*
- G. Trade secrets defined:** Information that "derives independent economic value, actual or potential, from not being generally known to and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use" and concerning which the owner has made "reasonable" efforts to "maintain its secrecy." R.I. Gen. Laws 1956, §6-41-1.

- H. **Remedies:** The remedy for a breach of a covenant not to compete may include both an injunction and damages, although an injunction may suffice. If the breach is not egregious, a court should grant an injunction alone. *Eastern Container Corp. v. Craine*, 624 A.2d 833, 835 (R.I. 1993).
- I. **Noteworthy cases summarizing scope of permissible/impermissible restraints:** *Durapin, Inc. v. American Products*, 559 A.2d 1051 (R.I. 1989); *Max Garelick, Inc. v. Leonardo*, 250 A.2d 354 (R.I. 1969); *Nestle Food Co. v. Miller*, 836 F. Supp. 69 (D.R.I. 1993).
- J. **Noteworthy article:** Mark W. Freel, Matthew T. Oliver, When Commercial Freedoms Collide: Trade Secrets, Covenants Not to Compete and Free Enterprise, 47 May R.I. B.J. 9 (1999).

## SOUTH CAROLINA

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## SOUTH CAROLINA

### I. SUMMARY OF THE LAW

Covenants against competition are disfavored and will be examined critically. A restrictive covenant will be enforced, however, if: (1) it is necessary to protect the legitimate business interests of the employer; (2) it is ancillary to a valid contract; (3) it is reasonably limited with respect to place and time; (4) it is neither unduly harsh nor oppressive; and (5) it is supported by valuable consideration. Geographic limitations must be based on what is reasonably-necessary to protect the employer. Prohibitions against contacting existing customers can be a valid substitution for a geographic limitation. *Rental Unif. Serv., Inc. v. Dudley*, 301 S.E.2d 142 (S.C. 1983).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Dudley*, 301 S.E.2d 142 (three-year restriction from working for competitor upheld); *Caine & Estes Ins. Agency, Inc. v. Watts*, 293 S.E.2d 859 (S.C. 1982) (agreement whereby employee must split commissions received on sales to former employer's clients for three years was reasonable); *Oxman v. Profitt*, 126 S.E.2d 852 (S.C. 1962) (covenant preventing employee from inducing or attempting to induce policyholders to terminate insurance upheld); *Standard Register Co. v. Kerrigan*, 119 S.E.2d 533 (S.C. 1961) (covenants of one to three years restricting employee from operating in former territory are reasonable); *Collins Music Co. v. Parent*, 340 S.E.2d 794 (S.C. Ct. App. 1986) (restriction allowing employee to work anywhere so long as employee does not contact former employer's customers is valid).
2. *Sermans v. Caine & Estes Ins. Agency, Inc.*, 273 S.E.2d 338, 339 (S.C. 1980) (statewide, unlimited time restriction invalid); *Oxman v. Sherman*, 122 S.E.2d 559 (S.C. 1961) (covenant restricting employee from working for any competitor in state unreasonable where employee formerly worked in only two counties); *Delmar Studios of the Carolinas v. Kinsey*, 104 S.E.2d 338 (S.C. 1958) (geographic restriction extending beyond territory where employee worked unenforceable).

#### B. Incidental to the sale of a business.

1. *Moser v. Gosnell*, 513 S.E.2d 123 (S.C. Ct. App. 1999) (three years, three counties as to "same business" enforced); *Cafe Assocs. Ltd. v. Gerngross*, 406 S.E.2d 162 (S.C. 1991) (five-year, five-mile radius covenant upheld); *South Carolina Fin. Corp. v.*

*West Side Fin. Co.*, 113 S.E.2d 329 (S.C. 1960) (25 mile restriction upheld).

2. *Somerset v. Reyner*, 104 S.E.2d 344 (S.C. 1958) (twenty-year statewide restriction invalid where buyer operated in only two cities).

### III. GENERAL COMMENTS

- A. Protectable interests: legitimate business interests-include goodwill, trade secrets, customer lists and other confidential information. *Almers v. South Carolina Nat'l Bank of Charleston*, 217 S.E.2d 135 (S.C. 1975); *Sermons*, 273 S.E.2d at 339.
- B. Where there are several restrictive provisions in an agreement, court will enforce some even if others are unenforceable. *Cafe Assocs.*, 406 S.E.2d at 165. But see *Somerset*, 104 S.E.2d at 348 (if the contract is not severable, court will not make a new agreement for the parties); *E. Bus. Forms Inc. v. Kistler*, 189 S.E.2d 22 (S.C. 1972) (same).
- C. When a covenant is entered into after inception of employment, separate consideration, in addition to continued at-will employment, is required for the covenant to be enforceable. *Poole v. Incentives Unlimited, Inc.*, 548 S.E.2d 207 (S.C. 2001).
- D. A forfeiture of benefits provision will be construed as strictly as a covenant against competition. *Almers*, 217 S.E.2d 135; *Wolf v. Colonial Life & Acc. Ins. Co.*, 420 S.E.2d 217, 220 (S.C. Ct. App. 1992).
- E. Is non-competition covenant enforceable if the employee is discharged? Depends on whether the discharge was justified or wrongful (i.e., not enforceable if employer breached). See *Williams v. Riedman*, 529 S.E.2d 28 (S.C. Ct. App. 2000) (state court case of first impression) (determining that employer breach of an employment contract, such as by wrongfully discharging the employee, operates to preclude the employer from enforcing a restrictive covenant contained in the contract).
- F. Attorneys' fees recoverable? Yes, if agreement provides for recovery.  
  
See *South Carolina Fin. Corp.*, 113 S.E.2d at 335 (attorneys' fees recoverable for breach of covenant against competition where agreement provided for recovery of fees if any provision of contract breached).
- G. Under South Carolina law, compensation given for a covenant not to compete is considered "nonmaterial in nature." *McElveen v. McElveen*, 506 S.E.2d 1, 5 (S.C. Ct. App. 1998).

- H. Will a choice of law provision in contract be followed? Unclear, but possibly so. See *Standard Register*, 119 S.E.2d at 536.
- I. Trade secrets defined: *Lowndes Products, Inc. v. Brower*, 191 S.E.2d 761 (S.C. 1972).
- J. Noteworthy articles/publications: (a) Keith A. Roberson, South Carolina's Inevitable Adoption of the Inevitable Disclosure Doctrine: Balancing Protection of Trade Secrets with Freedom of Employment, 52 S.C. L. Rev. 895 (2001); (b) Kirk T. Bradley, Employees Beware: Employer Rights Under the South Carolina Trade Secrets Act, 49 S.C. L. Rev. 597 (1998).
- K. Noteworthy case summarizing scope of permissible/impermissible restraints: See *Dudley*, 301 S.E.2d 142.

## SOUTH DAKOTA

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## SOUTH DAKOTA

### I. OVERVIEW OF THE LAW

#### A. Statutory Statement of the Law

1. S. D. Codified Laws Ann.
  - (a) Contracts in restraint of trade void, exceptions. Every contract restraining exercise of a lawful profession, trade, or business is void to that extent, except as provided by §§53-9-9 to 53-9-11, inclusive. S.D. Codified Laws Ann. §53-9-8.
  - (b) Sale of good will.—Seller’s agreement with buyer to refrain from carrying on similar business, validity. Any person who sells the good will of a business may agree with the buyer to refrain from carrying on a similar business within a specified county, city, or other specified area, as long as the buyer or person deriving title to the good will from the seller carries on a like business within the specified geographical area. S. D. Codified Laws Ann. §53-9-9.
  - (c) Dissolution of partnership – Agreement of partners to refrain from carrying on a similar business, validity. Partners may, upon or in anticipation of a dissolution of the partnership, agree that none of them will carry on a similar business within the same municipality where the partnership business has been transacted or within a specified part thereof. S. D. Codified Laws Ann. §53-9-10.
  - (d) Employment contract – Covenants not to compete. An employee may agree with an employer at the time of employment or at any time during his employment not to engage directly or indirectly in the same business or profession as that of his employer for any period not exceeding two years from the date of termination of the agreement and not to solicit existing customers of the employer within a specified county, city or other specified area for any period not exceeding two years from the date of termination of the agreement, if the employer continues to carry on a like business. S. D. Codified Laws Ann. §53-9-11.

#### B. Judicial Statements of the Law

1. Protectable interests: “same business or profession,” trade secrets, unfair competition, customers, confidential information and

business practices, and price lists. See S.D. Codified Laws Ann. §53-9-11; *Central Monitoring Serv., Inc. v. Zakinski*, 553 N.W.2d 513, 516 n.7 (S.D. 1996); *Centrol, Inc. v. Morrow*, 489 N.W.2d 890, 894-95 (S.D. 1992); *Hot Stuff Foods v. Mean Gene's Enterprises, Inc.*, 468 F. Supp. 1078 (D.S.D. 2006).

2. It appears that if a non-compete covenant meets the requirements of the South Dakota statutory provisions, the court will not further require a showing of reasonableness. *Centrol, Inc. v. Morrow*, 489 N.W.2d 890, 893 (S.D. 1992); *American Rim & Brake, Inc. v. Zoellner*, 382 N.W.2d 421, 424 (S.D. 1986). It therefore appears that an employer need only demonstrate compliance with S.D. Codified Laws Ann. §53-9-11. Generally, an employer is not required to demonstrate that the restraints imposed are reasonably necessary to protect its legitimate interests (as in most states), except in limited circumstances, such as employee discharge.

## II. CONSIDERATION ISSUES

### A. Adequate Consideration

1. A covenant not to compete signed at the inception of employment or at any time during employment is sufficient consideration. S.D. Codified Laws Ann. §53-9-11 (“An employee may agree with an employer at the time of employment or at any time during his employment...”); *Central Monitoring Service, Inc. v. Zakinski*, 553 N.W.2d 513, 517 n.9 (S.D. 1996). Under S.D. Codified Laws Ann. §53-8-7, additional consideration such as a change in the terms of employment is not necessary.<sup>6</sup> *Centrol, Inc. v. Morrow*, 489 N.W.2d 890,893 (S.D. 1992).

## III. PARAMETERS OF THE GOVERNING STATUTE AND THE “REASONABLENESS TEST” AS APPLICABLE

### A. Non-competes Ancillary to an Employment Contract

1. Held Enforceable
  - Reasonableness of restrictions received based on circumstances surrounding employee’s termination from employment. No balancing of interests necessary where

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<sup>6</sup> S.D. Codified Laws §53-8-7—Alteration of a written contract without new consideration. A contract in writing may be altered by a contract in writing without a new consideration or by an executed oral agreement, and not otherwise.

employee voluntarily quits job and goes into competition, and agreement complies with statutory requirements. See *American Rim & Brake, Inc. v. Zoellner*, 382 N.W.2d 421 (S.D. 1986); *Centrol, Inc. v. Morrow*, 489 N.W.2d 890 (S.D. 1992). However, if employee is fired through no fault of his own, the court must determine if agreement is reasonable based on a balancing test. See *Central Monitoring Service, Inc. v. Zakinski*, 553 N.W.2d 573 (S.D. 1996);

- Two-year term prohibiting competition in Kansas, Missouri, and surrounding areas held reasonably necessary to protect interest in confidential information *Hot Stuff Foods v. Mean Gene's Enterprises, Inc.*, 468 F. Supp. 1078, 1100, 1102 (D.S.D. 2006);
- See S.D. Codified Laws Ann. § 53-9-11. The statute restricts a covenant not to compete to a two-year term and must have a defined geographical term limiting its application.

## 2. Held Unenforceable or Modified

- If a non-compete covenant is overbroad, it can at least be “blue penciled.” *Simpson v. C & R Supply, Inc.*, 598 N.W.2d 914 (S.D. 1999); *Ward v. Midcom, Inc.*, 575 N.W. 2d 233 (S.D. 1998); *1st Am. Sys., Inc. v. Rezatto*, 311 N.W.2d 51, 59 (S.D. 1981).

## B. Non-competes Incidental to the sale of a business

- *Franklin v. Forever Venture, Inc.*, 696 N.W.2d 545 (S.D. 2005) (Seller’s contractual non-compete clause was void in part as against public policy to the extent it prevented more than “carrying on a similar business” as allowed by statute; yet, because South Dakota allows modification and because the contract had a savings clause, the court enforced the non-compete covenant, but only to the extent it prevented the seller from “carrying on a similar business.”);
- The absence of a geographic term in a contract incidental to the sale of a business does not necessarily void the contract where a geographic term may be implied. *Ward v. Midcom, Inc.*, 575 N.W.2d 233 (S.D. 1998).
- See S. D. Codified Laws Ann. §53-9-9.

## IV. GENERAL COMMENTS

## A. Specific Issues

1. Is a covenant not to compete enforceable if the employee is discharged? It depends. If an employee is terminated for reasons that are not the employee's fault, the court must determine whether the agreement is reasonable. *Central Monitoring Serv., Inc. v. Zakinski*, 553 N.W.2d 513, 521 (S.D. 1996). The Reasonable test is a balancing test drawn from RESTATEMENT (SECOND) OF CONTRACTS § 188. *Id.* at 519-20.
2. Are attorneys' fees recoverable? Generally, yes. Attorney's fees are available where they are authorized through a statutory provision or a contractual agreement. *Crisman v. Determan Chiropractic, Inc.*, 687 N.W.2d 507, 512 (S.D. 2004); *See also Midcom, Inc. v. Oehlerking*, 722 N.W.2d 722, 723, 728-29 (S.D. 2006) (awarding attorney's fees based on the contractual provisions); *Centrol, Inc. v. Morrow*, 489 N.W.2d 890, 896 (S.D. 1992) (awarding attorneys' fees based on S.D. Codified Laws Ann. §37-29-4(iii), from South Dakota's adoption of the Uniform Trade Secrets Act).
3. Will a choice of law provision in contract be followed? It depends on whether enforcement of the particular contract is consistent with South Dakota public policy. *Overholt Crop Inc. Service Co. v. Travis*, 941 F.2d 1361, 1366-68. (8th. Cir. 1991).

## B. Miscellaneous

1. Trade secrets defined: S.D. Codified Laws Ann. §37-29-1 (from South Dakota's adoption of the Uniform Trade Secrets Act). *See also Centrol, Inc. v. Morrow*, 489 N.W.2d 890, 894 (S.D. 1992).
2. Noteworthy articles and/or publications: Comment, *Employee Restrictive Covenants: Unscrupulous Employees v. Overreaching Employers*, 27 S.D.L. Rev. 220 (1982).
3. Noteworthy cases summarizing scope of permissible/impermissible restraints: *Simpson v. C & R Supply, Inc.*, 598 N.W.2d 914 (S.D. 1999); *Ward v. Midcom, Inc.*, 575 N.W. 2d 233 (S.D. 1998); *Central Monitoring Service, Inc. v. Zabinski*, 553 N.W.2d 573 (S.D. 1996); *Centrol, Inc. v. Morrow*, 489 N.W.2d 890 (S.D. 1992); *Am. Rim & Brake, Inc. v. Zoellner*, 382 N.W.2d 421 (S.D. 1986); *1st Am. Sys., Inc. v. Rezatto*, 311 N.W.2d 51 (S.D. 1981).

## TENNESSEE

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## TENNESSEE

### I. JUDICIAL STATEMENT OF THE LAW

#### A. Ancillary to an employment contract:

Covenants not to compete, because they are in restraint of trade, are disfavored in Tennessee. As such, they are construed strictly in favor of the employee. However, when the restrictions are reasonable under the circumstances, such covenants are enforceable. The factors that are relevant in determining whether a covenant not to compete is reasonable include “the consideration supporting the agreements; the threatened danger to the employer in the absence of such an agreement; the economic hardship imposed on the employee by such a covenant; and whether or not such a covenant should be inimical to public interest.”

*Vantage Technology, LLC v. Cross*, 17 S.W.3d 637, 644 (Tenn. Ct. App. 1999) (citations omitted), quoting in part *Allright Auto Parks, Inc. v. Berry*, 409 S.W.2d 361, 363 (Tenn. 1966); see also *Hasty v. Rent-A-Driver, Inc.*, 671 S.W.2d 471 (Tenn. 1984) (mere loss of employees insufficient to support enforcement).

#### B. Incidental to the sale of a business:

Outside the employer/employee relationship, covenants restricting competition have generally been upheld when they are incidental to the sale of a business. *Hogan v. Coyne International Enterprises Corp.*, 996 S.W.2d 195, 204 (Tenn. Ct. App. 1998).

"[A] covenant which is incidental to the sale and transfer of a trade or business, and which purports to bind the seller not to engage in the same business in competition with the purchaser, is lawful and enforceable," provided such covenants are reasonable and go no further than affording a fair protection to the buyer. *Greene County Tire and Supply, Inc. v. Spurlin*, 338 S.W.2d 597, 599-600 (Tenn. 1960) (citations omitted).

- C. The Tennessee Supreme Court held in 2005 that physicians' employment-related covenants not to compete were unenforceable as against public policy. *Murfreesboro Med. Clinic, P.A. v. Udom*, 166 S.W.3d 674, 683 (Tenn. 2005). However, in 2008 the *Udom* decision was superseded by statute. Tenn. Code Ann. § 63-1-148(a) allows covenants not to compete ancillary to a physician's employment contract if they are two years or less in duration and comply with permissible geographic restrictions. These restrictions may forbid a physician from practicing within the greater of a ten-mile radius of the physician's primary practice site or the county in which that practice site is located, or prevent him or her from practicing at any facility at which the employing or contracting entity provided services

while the physician was employed or contracted with the employing or contracting entity. *Id.* In connection with the sale of a medical practice, the statute provides no specific limitations on the scope of a covenant not to compete, but states that reasonable restrictions will be enforceable, and a rebuttable presumption exists that the duration and area of restriction agreed upon by the parties are reasonable. Tenn. Code Ann. § 63-1-148(b).

- D. The state's Code of Professional Responsibility may impose restrictions on the enforcement of covenants not to compete within the legal profession because such covenants operate to restrict the right to practice law. A.B.A. Sec. Lab. Emp. L. Rep. 451 (Supp. 1996)

## II. PARAMETERS OF THE "REASONABLENESS" TEST

### A. Ancillary to an employment contract:

1. Restraints upheld: *Vantage Technology, LLC v. Cross*, 17 S.W.3d 637, 638 (Tenn. Ct. App. 1999) (three-year covenant enforced against physician—area reduced to 50 miles from hospitals in which physician provided services); *Medical Education Assistance Corp. v. Tennessee*, 19 S.W.3d 803 (Tenn. Ct. App. 1999) (five-year covenant enforced against physician faculty member); *Dabora, Inc. v. Kling*, 884 S.W.2d 475, 478 (Tenn. App. 1994) (three-year nationwide restriction on accepting employment, owning, or being interested in, directly or indirectly, in any capacity with any other company or organization publishing a Saddlebred or Morgan horse publication, magazine, newspaper, trade journal, or any publication in competition with employer's magazine; court noted, "in the field of equestrian publishing, the relevant territorial inquiry does not involve geography so much as it does breed." *Thompson, Breeding, Dunn, Creswell & Sparks v. Bowlin*, 765 S.W.2d 743, 745-46 (Tenn. Ct. App. 1987) (three-year restriction on working for or soliciting present clients upheld against staff accountant); *William B. Tanner Co. v. Taylor*, 530 S.W.2d 517 (Tenn. Ct. App. 1974) (enforcing two-year restriction in North America on manager of sales of musical productions to radio and television stations); *Ramsey v. Mutual Supply Co.*, 427 S.W.2d 849 (Tenn. Ct. App. 1968) (enforcing covenant for five years in the four states which employer could reasonably anticipate including within salesman's coverage, though salesman had not made contacts in all the restricted territory at time of his resignation); *Koehler v. Cummings*, 380 F. Supp. 1294, 1308-09 (M.D. Tenn. 1971) (two-year, 31-state restraint on "idea man" responsible for marketing and research of safety garments is enforceable).

2. Restraints found unenforceable: *Girtman & Assocs. v. St. Amour*, 26 I.E.R. Cas. (BNA) 187, 2007 Tenn. App. LEXIS 271 (Tenn. Ct. App. Apr. 27, 2007) (covenant unenforceable because employer failed to prove it had a protectible business interest that would justify preventing former employee from using the knowledge and skill he gained through the generalized training he received); *Central Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 36 (Tenn. 1984) (covenant covering customers nationwide for two years reduced to one year and limited to customers as of date certain before resignation in areas where defendants worked before); *Allright Auto Parks*, 409 S.W.2d at 364 (covenant restricting competition in business beyond cities in which employee worked unreasonable; "noncompetition covenants, which embrace territory in which the employee never performed services for his employer, are unreasonable and unenforceable."); *Baker v. Hooper*, 50 S.W.3d 463, 469-70 (Tenn. Ct. App. 2001) (six-month covenant for nail technician too long - reduced to two months, "a sufficient time restriction to protect the plaintiff's business").

**B. Incidental to the sale of a business:**

1. Restraints upheld: *Hogan v. Coyne Int'l Enterprises Corp.*, 996 S.W.2d 195, 204 (Tenn. Ct. App. 1998) (ten-year covenant against soliciting former customers reduced to three years and enforced); *Greene County Tire*, 338 S.W.2d at 599-600 (enforcing seller's covenant not to engage in similar business within 100 miles for five years); *Rogers v. Harrell*, 1993 WL 305927 (Tenn. Ct. App. Aug. 11, 1993) (in sale of dental practice, upholding restriction on treating patients of record for five years and within 10 miles and on soliciting patients of record with no time limitation), op. modified, 1993 WL 350173 (Tenn. Ct. App. Sep, 9, 1993); *Butts v. Birdwell*, 503 S.W.2d 930, 937 (Tenn. Ct. App. 1973) (covenant not to sell oil products along three county route enforceable while buyer continues to serve the same route).

**III. GENERAL COMMENTS**

- A.** Protectible interests: goodwill, present customers and customer contacts (where employee may influence customer's decision), trade secrets, other confidential information not rising to level of a trade secret, an employee's unique or extraordinary services, and specialized training. See *Hasty v. Rent-A-Driver, Inc.*, 671 S.W.2d 471, 473 (Tenn. 1984) (protectible interests only arise where there are "special facts present over and above ordinary competition," such as: customer contact where employee has had special opportunity to cultivate customer; exclusive customer list; trade or

business secrets; other confidential information; and specialized training); *Thompson*, 765 S.W.2d at 745 (present clients); *Central Adjustment*, 678 S.W.2d at 32 (trade secrets or confidential information); *Selox, Inc. v. Ford*, 675 S.W.2d 474, 475 (Tenn. 1984) (trade secrets or confidential information and specialized training); *Cam Int'l. L.P. v. Turner*, 1992 WL 74567 (Tenn. Ct. App. April 15, 1992) (confidential information about customers); *Rogers*, 1993 WL 305927 (goodwill); *Koehler*, 380 F. Supp. at 1299 ("mad scientist's" ideas and services).

- B.** If a covenant is overbroad, it can be modified and enforced to the extent it is reasonable, especially when the covenant expressly provides for modification (unless there is evidence of employer bad faith). *Vantage Technology, LLC*, 17 S.W.3d at 647; *Central Adjustment*, 678 S.W.2d at 36-37; *Thompson*, 765 S.W.2d at 745.
- C.** Consideration must be reasonable. *Central Adjustment*, 678 S.W.2d at 35. Continued employment is sufficient consideration for a non-competition agreement, at least if the employment continues for "an appreciable period of time" afterward. *Id.* at 34. Covenant signed before, with or "shortly after" employment begins is considered part of original employment agreement and thus supported by adequate consideration. *Id.* at 33.
- D.** A forfeiture of benefits provision may be treated as a restraint of trade and thus subject to the same type of analysis. *See Spiegel v. Thomas, Mann & Smith, P.C.*, 811 S.W.2d 528, 531 (Tenn. 1991) (by rule, attorney may not agree to restriction except as condition to payment of retirement benefits; withholding deferred compensation "significant monetary penalty . . . [which] constitutes an impermissible restriction . . . . The forfeiture-for-competition provision would functionally and realistically discourage and foreclose a withdrawing partner from serving clients . . . .") (citations omitted). *But see Simmons v. Hitt*, 546 S.W.2d 587, 591 (Tenn. Ct. App. 1976) ("the provision that an employee who leaves and goes into direct competition with his employer forfeits his participation in the fund might be enforced, assuming notice and acceptance of such provision by the employees").
- E.** A non-compete may be enforceable if the employee is discharged. A court of equity will consider the circumstances under which the employee leaves. Where the employer discharges the employee in bad faith, a court may refuse to enforce the non-competition covenant, even where the discharge does not breach the employment agreement. *Central Adjustment*, 678 S.W.2d at 35. *But see Dearborn Chem. v. Rhodes*, 1985 Tenn. App. LEXIS 2809, \*9 (Tenn. Ct. App. Apr. 19, 1985) (non-compete enforceable when employee was terminated for just cause).

- F.** Attorney's fees. In an unpublished decision, the Tennessee Court of Appeals affirmed an award of attorney's fees to the defendant's former employer, though the text of the non-compete is not included in the court's decision. *Outfitters Satellite, Inc. v. CIMA, Inc.*, No. M2003-02074-COA-R3-CV, 2005 Tenn. App. LEXIS 86, \*9-10, 22 I.E.R. Cas. (BNA) 765 (Tenn. Ct. App. Feb. 8, 2005). However, the Court of Appeals has also stated that attorney's fees are not recoverable unless there exists an independent basis for such an award, such as if provided for in the covenant, *Hogan*, 996 S.W.2d at 204-05; *Central Adjustment*, 678 S.W.2d at 39; or for disobeying court order, *Kuydendall v. Latham*, 1991 WL 10178 (Tenn. Ct. App. 1991). A statute provides treble damages against a party procuring a breach of contract. Tenn. Code Ann. § 47-50-109 (1993) ("It shall be unlawful . . . to induce or procure the breach or violation, refusal or failure to perform any lawful contract . . . and . . . the person so procuring or inducing the same shall be liable in treble the amount of damages resulting from or incident to the breach of the contract.").
- G.** Will employer's breach of the employment agreement relieve the employee of his obligation not to compete? Yes, if the prior breach is material. See *Rogers*, 1993 WL 305927.
- H.** Will a choice of law provision in contract be followed? Yes, if law chosen is materially connected to transaction. *Goodwin Bros. Leasing, Inc. v. H & B, Inc.*, 597 S.W.2d 303, 306 (Tenn. 1980).
- I.** In 2000, Tennessee adopted the Uniform Trade Secrets Act (UTSA). See *Tenn. Code Ann. § 47-25-1701 et seq.* Prior to the adoption of the UTSA, Tennessee courts defined trade secrets via common law. See *Hickory Specialties, Inc. v. B & L Lab., Inc.*, 592 S.W.2d 583, 586 (Tenn. Ct. App. 1979) (adopting language similar to that in Restatement of Torts § 757); accord *Venture Express, Inc. v. Zilly*, 973 S.W.2d 602, 606 (Tenn. Ct. App. 1998); *Heyer Jordan & Assoc. v. Jordan*, 801 S.W.2d 814, 821 (Tenn. Ct. App. 1990).
- J.** Noteworthy articles and/or publications: Krumm, Covenants Not to Compete: Time for Legislative and Judicial Reform in Tennessee, 35 U. Mem. L. Rev. 447 (2005); Rettinger, Covenants Not to Compete in Tennessee, 3 Transactions 25 (2001); Comment, Covenants Not to Compete in Tennessee Employment Contracts: Almost Everything You Wanted to Know But Were Afraid to Ask, 55 Tenn. L. Rev. 341 (Winter 1988).
- K.** Noteworthy cases summarizing scope of permissible/impermissible restraints: *Central Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28

(Tenn. 1984); *Hasty v. Rent-A-Driver, Inc.*, 671 S.W.2d 471 (Tenn. 1984);  
Vantage Technology, LLC v. Cross, 17 S.W.3d 637 (Tenn. Ct. App. 1999).

## TEXAS

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## TEXAS

### COVENANTS NOT-TO-COMPETE UNDER TEXAS LAW

#### I. STATUTORY CRITERIA FOR NON-COMPETE AGREEMENTS

Sections 15.50-15.52 of the Texas Business and Commerce Code govern the enforceability of covenants not-to-compete. A covenant is enforceable if: (i) it is *ancillary* to or part of an *otherwise enforceable agreement* at the time the agreement is made; (ii) it contains reasonable limitations as to time, geographic area, and (iii) the scope of activity restrained does not impose a greater restraint than necessary to protect the goodwill or other business interest of the promisee.

If the primary purpose of the agreement to which the covenant is ancillary is for the rendering of personal services (i.e., an employment contract), the promisee/employer has the burden of establishing that the covenant meets the statutory criteria. If, however, the agreement has a different primary purpose, the promisor has the burden of establishing that the covenant does not meet those criteria. TEX. BUS. & COM. CODE ANN. § 15.51(b).

#### II. LEADING CASE LAW

The leading case in the non-compete arena in Texas is *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644, 651-655 (Tex. 2006), in which the Texas Supreme Court delineates the analytical framework for non-competes.

#### III. ELEMENTS OF ENFORCEABILITY

##### A. Agreements Arising in an Employment Context

Information or training given to the employee before the execution of the agreement will be considered past consideration, and thus will not support a covenant not to compete. *Light*, 883 S.W.2d at 645 n.6; *CRC-Evans Pipeline Int'l, Inc. v. Myers*, 927 S.W.2d 259, 265 (Tex. App. – Houston [1st Dist.] 1996, *no writ*). Accordingly, the employee should sign the non-competition agreement at the inception of employment. The threshold question the court will ask in considering the enforceability of a covenant not-to-compete is this: is there an enforceable agreement between the parties, separate and apart from the employee's promise not to compete? To constitute an "otherwise enforceable agreement" there must be a bilateral contract in which *each* party makes binding promises to the other. However, a covenant not to compete is not unenforceable solely because the "employer's promise [in the underlying agreement] is executory when made." *Alex Sheshunoff Mgmt.* at 655. A non-compete covenant may become enforceable in the future (assuming all other requirements are met) at the moment the employer performs its promise. *Alex Sheshunoff*

*Mgmt.* at 651. There are three critical points to keep in mind:

1. An employment at-will relationship is not an “otherwise enforceable agreement” that will support a covenant not-to-compete. *Light*, 883 S.W.2d at 444-45; *CRC-Evans*, 927 S.W.2d at 263. This does not mean there can be no enforceable covenant not-to-compete in the employment at-will context. It simply means there must be some other agreement between the employer and employee to which the covenant not-to-compete is ancillary. *Light*, 883 S.W.2d at 444-45.
2. The promises comprising the “otherwise enforceable agreement” cannot be dependent on any period of continued employment. The court will consider any such promise illusory because the employer can always avoid performance by simply terminating the employment. *Light*, 883 S.W.2d at 444-45; *CRC-Evans*, 927 S.W.2d at 262.
3. The “otherwise enforceable agreement” must give rise to the employer’s protectable interest. *Light*, 883 S.W.2d at 647. The Texas Supreme Court has held that the “otherwise enforceable agreement” may be merely the employer’s implied promise to provide confidential information to the employee “if the nature of the employment for which the employee is hired will reasonably require the employer to provide confidential information to the employee.” *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, (Tex. 2009). The Fifth Circuit has similarly held that the employee’s actual receipt of confidential information during employment is sufficient to support a non-solicitation or non-competition agreement. *Carpenter v. Provenzale*, 334 F.3d 459, 466 (5th Cir. 2003).

**B. Geographic Territory Restrictions:** Relevant factors courts consider in assessing the reasonableness of the covenant’s geographic scope include: (i) the area in which the employer does business; (ii) the nature and scope of the employer’s business; (iii) the true significance of geography to the employer’s business; (iv) the physical location of the employer’s customer/clients; (v) the geographic area from which the company pulls its customers/clients; (vi) the location/area in which the employee worked and performed services for the employer. Courts have generally held reasonable geographic restrictions include the territory/area in which the employee worked and performed services for the employer. See e.g., *Curtis v. Ziff*, 12 S.W.3d 114 (Tex. App. - Houston [14th Dist.] 1999, *no writ*); *Evan’s World Travel, Inc. v. Adams*, 978 S.W.2d 225, 232 (Tex. App. - Texarkana 1998, *no writ*).

- C. Time Limitations:** The shorter the time period, the more likely the covenant will be enforced. Generally speaking, time limitations up to two years are enforced more readily than longer periods.<sup>7</sup> See, e.g., *Alex Sheshunoff Mgmt.* at 657 (enforcing covenant prohibiting employee from providing consulting services to employer's clients for one year and from selling competing product for two years); *Property Tax Assoc. v. Staffeldt*, 800 S.W.2d 349, 350 (Tex. App.--El Paso, writ denied) (finding two-year restriction to be reasonable). Some of the factors relevant to assessing whether a court will consider the duration of the agreement reasonable include: (i) the length of the time the employee worked for the employer; (ii) the exact nature of the employee's duties and responsibilities; (iii) whether the relationship with customers/clients existed before the employee began work for the employer; (iv) the extent of the employee's contact with customers; (v) whether the employee maintained complete customer contact to the exclusion of others within the employer's organization; (vi) the applicable business cycle; and (vii) the rate of progress or innovation in the industry.
- D. Scope of Activity Restrained:** Most non-compete agreements contain one or both of the following: (1) a prohibition against engaging in a competing business; or (2) a prohibition against soliciting or doing business with the employer's customers. Generally, a prohibition against engaging in a competing business should be limited to not only the type of business in which the company is engaged, but also, the specific type of business in which the employee worked. Thus, if the employer engages in different types of businesses, the restriction should be limited to the specific type of business in which the employee worked. See *Diversified Human Resources Group, Inv. v. Levinson-Polakoff*, 752 S.W.2d 8 (Tex. App. - Dallas 1998, no writ).

As for a prohibition against soliciting customers, courts have held that these non-solicitation provisions are "covenants not-to-compete" subject to the requirements of the non-compete statute and *Light v. Centel*. See *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 599 (Tex. App. - Amarillo 1995, no writ); *Shoreline Gas, Inc. v. McGaughey*, 2008 WL 1747624 (Tex. App. Corpus Christi Apr. 17, 2008). Prohibitions against soliciting customers must be reasonable to be enforceable. To be considered reasonable, such a restriction should generally be limited to customers with whom the employee actually worked or had some contact or involvement during employment. See *Hardy v. Mann Frankfort Stein &*

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<sup>7</sup> Courts are more likely to enforce restrictions of a longer period if the covenant is executed in connection with the sale of a business.

*Lipp Advisors, Inc.*, 263 S.W.3d 232, 250 (Tex. App. Houston 1st Dist. 2007); *Peat Marwick Main & Co. v. Hauss*, 818 S.W.2d 381 (Tex. 1991).

- E. Protectable Interests:** The simple payment of money in exchange for signing the non-compete will not be considered sufficient consideration, as it does not give rise to a protectable interest. By contrast, special training involving confidential or proprietary information may constitute a legitimate, protectable interest. See *Light*, 883 S.W.2d at 647. General training, knowledge, skills and experience acquired by the employee during employment are not protectable interests. *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 231 (Tex. App. - Texarkana 1998, *no writ*).

An employer's confidential information and trade secrets are protectable interests. Thus, an express or implied promise by the employer to provide such information may be the "otherwise enforceable agreement" to which a covenant not-to-compete is ancillary. See *Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, (Tex. 2009); *Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114 (Tex. App. - Houston [14th Dist.] 1999, *no writ*); *Ireland v. Franklin*, 950 S.W.2d 155, 158 (Tex. App. - San Antonio 1997, *no writ*).

An employment agreement for a specific term, or by which the employee may be terminated only "for cause," is, by itself, insufficient to support a non-compete. The mere fact of employment does not give rise to any interest protectable through a covenant not-to-compete. See *Light*, 883 S.W.2d 646 n.10 (covenant not-to-compete would not be ancillary to contract for a term of two weeks). In other words, while a term contract of employment is an "otherwise enforceable agreement," it, by itself, does not give rise to a protectable interest.

- F. Consideration:** Even if there is an "otherwise enforceable agreement," it must still be established that the covenant not-to-compete is "ancillary" to that agreement. The Texas Supreme Court's interpretation of "ancillary" means that many of the forms of consideration ordinarily sufficient to support a covenant not-to-compete are not sufficient. The Texas Supreme Court addressed in *Alex Sheshunoff Mgmt.* the statutory language requirement that a covenant not to compete be ancillary to "an otherwise enforceable agreement at the time the agreement is made" and concluded that the phrase "at the time the agreement is made" refers not to whether the agreement is enforceable, but rather to whether the covenant is ancillary to or part of the agreement. *Alex Sheshunoff Mgmt.* requires *two* things to have an enforceable covenant not-to-compete. First, the employer must give consideration in an otherwise enforceable agreement. Second, the non-compete covenant must be designed to

enforce the employee's consideration or return promise. Without both requirements, the covenant is void as not ancillary to or part of an otherwise enforceable agreement.

Thus, an employer may not enforce a non-compete covenant merely by promising to pay a sum of money to the employee or by agreeing to give the employee at least two weeks notice before terminating the employee because that would mean that an employer could enforce a covenant merely by promising to give notice or to pay a sum of money to an employee, a result that is inconsistent with both requirements. *W Insulation Co., Inc. v. Dickey*, 144 S.W.3d 153, 158 (Tex. App.--Fort Worth 2004, *pet. withdrawn*) As other example, if an employer promised to give employee trade secrets but employee did not promise not to disclose them after leaving employment, the non-compete covenant would be void. *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642, 647 (Tex. 1994).

Given the requirements of *Alex Sheshunoff Mgmt.* and the problems with past consideration, it is usually impossible to fashion an enforceable covenant not-to-compete in the context of a severance agreement. Payment of severance pay does not give rise to any interest worthy of protection through a covenant not-to-compete.

**G. Judicial modification:** Texas courts are empowered to reform overbroad covenants to the extent necessary to bring them into compliance with the statute. TEX. BUS. & COM. CODE ANN. § 15.51(c). Because of this, some employers take the approach that the covenant should be drafted broadly to have the maximum deterrent effect, and then rely on the court to reform and enforce the covenant to the extent deemed reasonable. There are several reasons, however, why this is not a good idea:

1. The court may not award the employer damages for a breach of the covenant before its reformation, and any relief granted is limited to injunctive relief. TEX. BUS. & COM. CODE ANN. § 15.51(c).
2. If the employee can prove the employer knew at the time the agreement was executed that the restrictions were not reasonable and necessary, and the employer sought to enforce a covenant to a greater extent than necessary to protect its goodwill and business interest, the court may award the employee attorney's fees and costs incurred in defending an action to enforce the covenant. TEX. BUS. & COM. CODE ANN. § 15.51(c).

#### IV. AGREEMENTS ANCILLARY TO THE SALE OF BUSINESS

Generally, covenants not to compete which are made at the sale of a business follow the same provisions and guidelines as covenants not to compete in the employer/employee context. See *Light*, 883 S.W.2d at 644 n.4. (agreement not to compete must be ancillary to an otherwise valid transaction or relationship.... Such a restraint on competition is unreasonable unless it is part of and subsidiary to an otherwise valid transaction or relationship, which gives rise to an interest worthy of protection.... Such transactions or relationships include the purchase and sale of a business, and employment relationships) (quoting *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 681-82 (Tex.1990)).

In *Wells v. Powers*, 354 S.W.2d 651 (Tex. Civ. App.–Dallas 1962, *no writ*), the Dallas Court of Appeals held that the term “engage in a competitive business,” as used in non-competitive clause of a contract for sale of a business, includes activities of seller in working as an employee of party operating a competing business. See also *Comer v. Burton-Lingo Co.*, 58 S.W. 969 (Tex. Civ. App. 1900) (an agreement by an owner, on sale of his business and good will, not to re-enter such business within a specified time at a certain place, is not void as in restraint of trade). Nevertheless, covenants not to compete must not impose greater restraint than is reasonably necessary to protect business conveyed. *Barrett v. Curtis*, 407 S.W.2d 359 (Tex. App.–Dallas 1966, *no writ*); see also *T. E. Moor & Co. v. Hardcastle*, 421 S.W.2d 126 (Tex. App.–Beaumont 1967, *ref. n.r.e.*) (a seller of a business may validly agree not to compete with buyer, and employee may validly agree not to compete with employer, as long as restraint imposed is reasonable).

## V. SUMMARIZATION OF TEXAS LAW WITH REGARD TO THE USE OF CONFIDENTIAL INFORMATION

Employees have a common law duty not to use or disclose confidential information received from a former employer. Even without an enforceable contractual restriction, “a former employee is precluded from using for his own advantage, and to the detriment of his former employer, confidential information or trade secrets acquired by or imparted to him in the course of his employment.” *Johnston v. American Speedreading Academy, Inc.*, 526 S.W.2d 163, 166 (Tex. App.—Dallas 1975, *no writ*). See also *Rugen v. Interactive Business Systems, Inc.*, 864 S.W.2d 548 (Tex. App.—Dallas 1993 *rehearing denied*). Injunctive relief is recognized as a proper remedy to protect confidential information and trade secrets. *Hyde Corp. v. Huffines*, 358 U.S. 898 (1958). See also *Keystone Life Ins. Co. v. Marketing Management, Inc.*, 687 S.W.2d 89, 93 (Tex. App.—Dallas 1985, *no writ*) (an injunction is appropriate when necessary to prohibit an employee from using confidential information to solicit his former employer's clients).



## UTAH

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## UTAH

### I. STATUTORY AUTHORITY

Utah has no statute governing the enforceability or reasonableness of covenants not to compete.

### II. SUMMARY OF LAW

Covenants not to compete are enforceable if narrowly drafted to protect only the legitimate interests of the employer. See *Robbins v. Finlay*, 645 P.2d 623, 627 (Utah 1982). To be enforceable the covenant not to compete must be: a) supported by consideration, b) negotiated in good faith, c) necessary to protect a company's good will, and d) reasonably limited in time and geographic area. See *TruGreen Cos., L.L.C. v. Mower Brothers*, 2008 UT 81 (2008) (citing *Allen v. Rose Park Pharmacy*, 237 P.2d 823, 828 (Utah 1951)). The primary consideration is the covenant's reasonableness. See *Robbins* at 627. "The reasonableness of a covenant depends upon several factors, including its geographical extent; the duration of the limitation; the nature of the employee's duties; and the nature of the interest which the employer seeks to protect such as trade secrets, the goodwill of his business, or an extraordinary investment in the training or education of the employee." See *Robbins* at 627. Utah law "balances the nature of the interest of one seeking to enforce such a covenant . . . against the hardship imposed on the employee as the result of the restraint." *Id.* Those covenants not to compete that are designed primarily to limit competition are not enforceable. See *id.*; see also *Allen* at 826.

### III. ELEMENTS OF ENFORCEABILITY

#### A. Protectable Interest

Covenants not to compete are enforceable "only if carefully drawn to protect the legitimate interests of the employer." *Robbins* at 623. Protectable interests include trade secrets, the goodwill of a business, or the investment in education or training of an employee. See *System Concept Inc. v. Dixon*, 669 P.2d 421, 426 (Utah 1983); *Robbins* at 627-28; *Allen* at 823. While some courts have held that goodwill, standing alone, is a protectable interest, *Allen* at 823, other courts have held that in order to justify a injunction enforcing a restrictive employment covenant, the former employer must show not only goodwill, but also that the services rendered by the employer were special, unique or extraordinary. See *Robbins* at 627-628 (court denied injunction where plaintiff employer could not demonstrate that former salesman had unique knowledge of plaintiff's business and covenant did nothing more "than baldly restrain competition.").

## **B. Burden on Employee**

Utah courts analyze the burden on the employee by looking at the type of activity restricted by the covenant not to compete. For example, in *System Concepts, Inc.*, the court found that there no undue hardship on former employee because covenant not to compete was limited to the employee rendering services to a competitor or dealing in “conflicting products.” *System Concepts* at 429. The agreement did not restrict employment within the entire industry. *Id.* See also *Allen* at 826 (restrictive covenant which prohibited pharmacist/store manager from competing with former employer within a two-mile radius of employer’s pharmacy for a period of five years did not create a sufficient hardship to justify voiding the contract).

## **C. Reasonableness Requirements**

“The reasonableness of the restraints in a restrictive covenant is determined on a case-by-case basis, taking into account the particular facts and circumstances surrounding the case and the subject of the covenant. Of primary importance in the determination reasonableness are the location and nature of the employer’s clientele.” *System Concepts* at 427 (court upheld a covenant not to compete that had no geographic restriction where the business and clientele of the employer were national rather than local). *Allen v. Rose Park Pharmacy*, 237 P.2d 823 (Utah 1951) (court upheld restrictive covenant which prohibited pharmacist/store manager from competing with former employer within a two-mile radius of employer’s pharmacy).

Time restrictions in covenants not to compete must be reasonable, which is determined on a case by case basis. *Kasco Services Corp. v. Benson*, 831 P.2d 86 (Utah 1992) (eighteen-month covenant not to compete by a salesman in sales territory upheld); *Robbins* at 623 (restrictive covenant that prohibited competition for one year was unreasonable because former employee lacked unique skills or knowledge and agreement was designed solely to stifle fair competition); *Allen* at 823 (court upheld restrictive covenant which prohibited pharmacist/store manager from competing with former employer for a period of five years).

## **D. Scope of Activity**

An employer seeking to enforce a covenant must show that the services of the employee were special, unique or extraordinary. *Allen v. Rose Park Pharmacy*, 237 P.2d 823, 828 (Utah 1951); *overruled on other grounds*, *System Concepts, Inc. v. Dixon*, 669 P.2d 421 (Utah 1983). Further, the type of activity limited by the covenant not to compete is important in

determining whether the agreement should be enforced. See *System Concepts, Inc.* at 429 (no undue hardship on former employee because covenant not to compete was limited to the employee rendering services to a competitor or dealing in “conflicting products”).

#### **E. Consideration**

The promise of at-will employment is sufficient consideration to support a covenant not to compete. See *Allen* at 825. A change in the terms and conditions of employment will provide sufficient consideration to support a covenant not to compete entered into after the employment relationship has already begun. See *Systems Concepts* at 429 (covenant not to compete signed more than two months after defendant began her employment was supported by consideration; defendant received raises and promotions after beginning her employment and before signing the agreement).

### **IV. ADDITIONAL COMMENTS**

#### **A. Court Reformation**

Utah courts have not specifically addressed the question of whether a court may modify an overbroad covenant not to compete and then enforce it.

#### **B. Enforceability if Employee Terminated**

A covenant not to compete may be enforceable even though the employee is discharged. See *Allen* at 823. However, the termination must be in good faith. *Id.* at 826.

#### **C. Choice of Law Provisions**

The Tenth Circuit Court of Appeals determined that Utah would look to general contract principles as enunciated in Restatement (Second) of Conflict of Laws § 187 in resolving whether parties can agree upon on a choice of law provision. *Electrical Distribs., Inc. v. SFR, Inc.*, 166 F.3d 1074, 1083-84 (10th Cir. 1999). Accordingly, parties may agree to a choice of law provision unless either “(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties choice, or (b) application of the chosen state law would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state ...”. *Id.*

#### **D. Sale of Business**

Covenants not to compete upon the sale of a business are enforceable under same legal principles that govern such agreements in the employer-employee context. See *Electrical Distribs., Inc. v. SFR, Inc.*, 166 F.3d 1074, 1085-86 (10th Cir. 1999) (applying Utah law, the court held that a seven year prohibition on competing in the electrical distribution business throughout the entire state of Utah was enforceable); *Rudd v. Park*, 588 P.2d 709 (Utah 1978) (covenant not to compete incidental to the sale of a business was unenforceable on seller's death within the 5 year restricted period because covenant was a personal covenant); *Valley Mortuary v. Fairbanks*, 225 P.2d 739 (Utah 1950) (court upheld covenant in connection with the sale of a funeral business which required the seller not to operate such a business in Utah for a period of 25 years).

#### **E. Attorneys' Fees**

Utah prescribes to the American rule regarding the recovery of attorneys' fees, which is that each party generally is responsible for its own attorneys' fees. Under Utah law "attorneys' fees are awardable only if authorized by statute or contract." *R.T. Nielson Co. v. Cook*, 40 P.3d 1119, 1125 (Utah 2002) (citations omitted). Accordingly, attorneys' fees may be available if provided for in the covenant not to compete.

## VERMONT

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## VERMONT

### I. SUMMARY OF THE LAW

Covenants not to compete are enforced "subject to scrutiny for reasonableness and justification." Non-competition agreements are valid and enforceable unless found contrary to public policy, unnecessary for protection of the employer, or unnecessarily restrictive of the employee's rights. Both the subject matter of the contract and surrounding circumstances are relevant considerations in making this determination. An employee who is trying to avoid enforcement of a covenant not to compete has the burden of proving that the covenant is unreasonable.

*Roy's Orthopedic, Inc. v. Lavigne*, 454 A.2d 1242, 1244 (Vt. 1982); *Vermont Elec. Supply Co. v. Andrus*, 315 A.2d 456, 458 (Vt. 1974).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Vermont Electric Supply Co., Inc. v. Andrus*, 315 A.2d 456 (Vt. 1974) (upholding five-year, one-county, non-competition agreement; the court emphasized that employee's voluntary departure with the intention to compete with employer was a substantial consideration in determining the enforceability of covenants not to compete); *Dyar Sales & Mach. Co. v. Bleiler*, 175 A. 27, 30 (Vt. 1934) (upholding non-competition agreement that extends to territory wherein employer's trade may be likely to go).
2. *Roy's Orthopedic, Inc. v. Lavigne*, 454 A.2d 1242, 1243 (Vt. 1982) (refusing to enforce, and remanding for a new trial a case involving, a covenant that restricted an employee of a manufacturing company from competing for three years in any "territories presently served by corporation and those additional territories to which the [employee] knows the corporation intends" to extend its business, on the basis that the geographical restrictions were insufficiently developed in the court below).

#### B. Incidental to the sale of a business.

1. *Fine Foods, Inc. v. Dahlin*, 523 A.2d 1228 (Vt. 1986) (finding reasonable a restriction imposed on seller of restaurant to not engage in any similar business within a 25-mile radius for five years); *Cf. Addison County Automotive, Inc. v. Church*, 481 A.2d 402 (Vt. 1984) (stating that covenant in lease agreement giving lessee exclusive right to sell automotive accessories on the

premises was neither overly broad nor unreasonable); *Clark v. Crosby*, 37 Vt. 188 (1864) (finding valid an agreement whereby dentist bought artificial teeth on condition that manufacturer would not sell such teeth to any person in the town where the dentist resided).

### III. GENERAL COMMENTS

- A. **Protectible interests:** Sale of goodwill, confidential information, customer relations, and investment in special training. See *Vermont Elec. Supply Co. v. Andrus*, 315 A.2d 456, 458 (Vt. 1974); *Abalene Pest Control Serv. v. Hall*, 220 A.2d 717 (Vt. 1966); *Dyar Sales & Mach. Co. v. Bleiler*, 175 A. 27 (Vt. 1934).
- B. **Covenant Reformation:** Vermont courts will not modify an overbroad covenant to make it enforceable. *Roy's Orthopedic, Inc. v. Lavigne*, 487 A.2d 173, 175 (Vt. 1985) (emphasizing that the terms of the non-competition agreement were a matter of contract between the parties that the court would not alter).
- C. **Consideration:** Continued employment is sufficient consideration for a non-competition agreement regardless of when the agreement was presented to and signed by the employee. See, *Dyar Sales & Mach. Co. v. Bleiler*, 175 A. 27, 28 (Vt. 1934) (court enforced covenant entered into two years after inception of employment); *Summits 7, Inc. v. Staci Kelly*, 886 A.2d 365 (Vt. 2005) (A noncompetition agreement presented to an employee at any time during the employment relationship is ancillary to that relationship and thus requires no additional consideration other than continued employment. Regardless of what point during the employment relationship the parties agree to a covenant not to compete, legitimate consideration for the covenant exists as long as the employer does not act in bad faith by terminating the employee shortly after the employee signs the covenant).
- D. **Attorneys' fees:** Attorneys' fees ordinarily are unrecoverable in absence of statutory authority or specific agreement of the parties. *Highgate Associates Ltd. v. Merryfield*, 597 A.2d 1280 (Vt. 1991); *Myers v. Ambassador Ins. Co., Inc.*, 508 A.2d 689 (Vt. 1986); *Cameron v. Burke*, 572 A.2d 1361 (Vt. 1990) (yet equity court may grant fees in exceptional cases as justice requires, as where litigants act in bad faith or their conduct is unreasonably obstinate).
- E. **Trade secrets defined:** "Information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (A) derives independent economic value, actual or potential, from not being

generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (B) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.” 9 V.S.A. § 4601(3). See also *Dicks v. Jensen*, 768 A.2d 1279 (Vt. 2001).

- F. At-will employees:** If not otherwise subject to a noncompetition contract, at-will employees may plan to compete with their employer even while still employed there and may freely compete with the employer once they are no longer employed there. This is not a breach of a duty of loyalty. But, at-will employees are still restricted from misappropriating trade secrets and soliciting customers for their new venture while still employed by the former employer, even if not subject to confidentiality, nondisclosure or noncompetition restrictions. When an employer does not take steps to protect information, such as customer lists, competition for those customers by such former employees is legitimate. *Omega Optical, Inc. v. Chroma Technology Corp.*, 800 A.2d 1064 (Vt. 2002).
- G. Noteworthy cases summarizing scope of permissible/impermissible restraints:** See *Abalene Pest Control Serv. v. Hall*, 220 A.2d 717 (Vt. 1966); *Dyar Sales & Mach. Co. v. Bleiler*, 175 A. 27 (Vt. 1934).
- H. Noteworthy articles and/or publications:** P. Jerome Richey, American Bar Association, Covenants Not to Compete, 588-95 (1991); William G. Porter II and Michael C. Griffaton, Using Noncompete Agreements to Protect Legitimate Business Interests, 69 Def. Couns. J. 194 (Apr. 2002).

## VIRGINIA

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## VIRGINIA

### I. SUMMARY OF THE LAW

A covenant restraining an employee will be enforced if its restrictions are no greater than necessary to protect the employer's legitimate business interests, if it is not unduly harsh or unreasonable in curtailing the employee's ability to earn a living and if the agreement does not violate public policy. Since a non-competition covenant is a restraint on trade, it will be strictly construed before it is enforced. *Blue Ridge Anesthesia & Critical Care, Inc. v. Gidick*, 389 S.E.2d 467 (Va. 1990); *Paramount Termite Control Co. v. Rector*, 380 S.E.2d 922, 925 (Va. 1989).

Under Virginia law, the employer bears the burden of showing that the restraint is reasonable and no greater than necessary to protect the employer's legitimate business interests. *Omniplex World Servs. Corp. v. US Investigations Servs.*, 618 S.E.2d 340 (Va. 2005); *Motion Control Sys., Inc. v. East*, 546 S.E.2d 424 (Va. 2001); *Simmons v. Miller*, 544 S.E.2d 666 (Va. 2001).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Mutual Funding, Inc. v. Collins*, No. CH02-947, 2003 WL 21057572 (Va. Cir. Ct. May 5, 2003) (three year, 60 mile radius from each city where former employer has office is "not unenforceable per se"); *Auto-Chlor Sys. of Northern Virginia v. Church*, No. CH00-698, 2000 WL 33340687 (Va. Cir. Ct. Sept. 28, 2000) (restricting former employee from working for any competitor in any city, county, or state serviced by former employer for 1 year); *Advanced Marine Enterprises, Inc. v. PRC, Inc.*, 501 S.E.2d 148 (Va. 1998) (enforcing non-compete agreement of eight month, fifty miles from former employer's office; geographic limitation not too burdensome even though former employer has approximately 300 offices worldwide); *New River Media Group, Inc. v. Knighton*; 429 S.E.2d 25 (Va. 1993) (60-mile, one-year restriction upheld); *Blue Ridge Anesthesia*, 389 S.E.2d 467 (three-year restriction from territory serviced by employee held reasonable); *Paramount Termite Control*, 380 S.E.2d at 925 (two-year restriction in counties where employer operated was reasonable); *Roanoke Eng. Sales v. Rosenbaum*, 290 S.E.2d 882, 884 (Va. 1982) (restricting employee from selling in employer's territory reasonable where territories virtually co-extensive).
2. *Omniplex World Servs. Corp.*, 618 S.E.2d 340 (Va. 2005) (covenant overbroad and unenforceable where covenant restricts employment even in a capacity that is not in direct competition with

former employer); *Modern Env'ts, Inc. v. Stinnett*, 561 S.E.2d 694 (Va. 2002) (covenant prohibiting former employee from being employed in any capacity by employer's competitor was unenforceable because employer did not carry its burden of showing that the covenant was reasonable and no greater than necessary to protect a legitimate business interest); *Motion Control Sys., Inc.*, 546 S.E.2d 424 (covenant overbroad and unenforceable where restricted activities could include a wide range of enterprises unrelated to business of former employer; *Simmons*, 544 S.E.2d 666 (refusing to enforce covenant which contained an expansive list of restrictive functions and had no geographical limitation); *John J. Wilson Assocs., Inc. v. Smith*, No. CH00-18002, 2000 WL 1915928 (Va. Cir. Ct. Oct. 20, 2000) (covenant overbroad and unenforceable where geographic limitation was the Commonwealth of Virginia); *Lawrence v. Bus. Communics. Of Virginia*, No. CH99-1134, 2000 WL 33340626 (Va. Cir. Ct. May 5, 2000) (finding restrictive covenant geographically and functionally overbroad); *Nida v. Bus. Advisory Sys., Inc.*, Law No. 95-248, 1998 WL 972125 (Va. Cir. Ct. Mar. 2, 1998) (finding covenant that prohibits employee from providing independent services to a lender anywhere in the world to be overbroad and unenforceable); *Alston Studios, Inc. v. Lloyd V. Gress & Assocs.*, 492 F.2d 279 (4th Cir. 1974) (covenant too broad where it covered activities in which employee had not been engaged and had no geographic limitation); *Richardson v. Paxton Co.*, 127 S.E.2d 113, 117 (Va. 1962) (three-year non-competition agreement held unduly harsh, overbroad and unenforceable because it prohibited employee from competing in areas in which the employer had no legitimate business activities).

## **B. Incidental to the sale of a business.**

1. *In re: Property Technologies Ltd.*, 296 B.R. 701 (E.D. Va. 2002) (failure to make the non-compete payments as specified in the agreement rendered the non-compete agreements void 30 days after the payments were due); *Musselman v. Glass Works*, 533 S.E.2d 919 (Va. 2000) (purchase agreement and 5 year, 100 mile radius non-compete agreement were integrated and enforceable); *Stoneman v. Wilson*, 192 S.E. 816 (Va. 1937) (reasonable restraints will be enforced). See also *Nat'l Homes Corp. v. Lester Indus., Inc.*, 293 F. Supp. 1025 (W.D. Va. 1968), *aff'd in part and rev'd in part*, 404 F.2d 225 (4th Cir. 1968).

## **III. GENERAL COMMENTS**

- A. Protectable interests: customer contacts, methods of operation, trade secrets and other confidential information that does not rise to the level of a trade secret. *Paramount Termite Control*, 380 S.E.2d at 925; *Roanoke Eng'g Sales*, 290 S.E.2d at 885; *Blue Ridge Anesthesia*, 389 S.E.2d at 469.
- B. Virginia state courts have thus far declined to adopt the "blue pencil" rule or any other rule for modifying non-competition covenants. However, the United States District Court for the Western District of Virginia, in *Orkin Exterminating Co., Inc. v. Farmer*, 1988 U.S. Dist. Lexis 16432 (W.D. Va. 1988), revised an overbroad geographic restriction in an agreement the court found severable.
- C. Continued employment may be sufficient consideration for a non-competition agreement, but it depends on the facts and circumstances of the case. *Mona Elec. Group, Inc. v. Truland Serv. Corp.*, 193 F.Supp.2d 874 (E.D. Va. 2002), *aff'd*, 2003 WL 40748 (4th Cir. 2003) (applying Virginia law and finding that the restrictive covenant was unenforceable because it lacked consideration); *Paramount Termite Control*, 380 S.E.2d at 926 (finding that continued employment is sufficient consideration for a non-competition agreement).
- D. Covenant not to compete survives expiration of employment agreement when a reasonable offer of continued employment is made and rejected. *Carilion Healthcare Corp. v. Ball*, Nos. CH00-732, CH01-78, 2001 WL 1262362, at \*5 (Va. Cir. Ct. Feb. 23, 2001).
- E. Will a choice of law provision in contract be followed? While Virginia courts generally uphold contractual choice of law provisions, it is unclear if they would do so if the non-competition agreement would be overbroad and unenforceable in Virginia. See *Paul Bus. Sys. v. Canon, U.S.A.*, 397 S.E.2d 804, 807 (Va. 1990).
- F. Trade secrets defined: *Dionne v. Southeast Foam Converting & Packaging, Inc.*, 397 S.E.2d 110 (Va. 1990).
- G. Noteworthy articles and/or publications: Thomas M. Winn, III, Annual Survey of Virginia Law: Labor and Employment Law, 37 U. Rich. L. Rev. 241 (2002) (published annually and includes recent developments in Virginia regarding covenants not to compete); Boyette & Billingsley, Employment Law, 24 U. Rich. L. Rev. 567-81 (1990); Hill, Covenants Not-to-Compete: Are They Enforceable in Virginia?, 16 Va. B.A.J. 4(7) (1990).

- H. Noteworthy cases summarizing scope of permissible/impermissible restraints: See *Omniplex World Servs. Corp.*, 618 S.E.2d 340; *Blue Ridge Anesthesia*, 389 S.E.2d 467.

## WASHINGTON

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## WASHINGTON

### I. JUDICIAL STATEMENT OF THE LAW

It is well established that covenants not to compete upon termination of employment are enforceable if they are reasonable. Whether a covenant is reasonable involves a consideration of three factors: (1) whether restraint is necessary for the protection of the business or goodwill of the employer, (2) whether it imposes upon the employee any greater restraint than is reasonably necessary to secure the employer's business or goodwill, and (3) whether the degree of injury to the public is such loss of the service and skill of the employee as to warrant nonenforcement of the covenant.

*Knight v. McDaniel*, 37 Wn. App. 366, 369 (1984) (internal quotations omitted); see also *Alexander & Alexander, Inc. v. Wohlman*, 19 Wn. App. 670, 578 P.2d 530 (1978); *Sheppard v. Blackstock Lumber Co.*, 85 Wn.2d 929, 540 P.2d 1373 (1975); *Wood v. May*, 73 Wash. 2d 307, 438 P.2d 587 (1968); *Racine v. Bender*, 141 Wash. 606, 252 P.115 (1927).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract:

*Racine v. Bender*, 141 Wash. 606, 615, 252 P. 115 (1927) (upholding a 3-year restriction on soliciting or performing services for former clients).

*Wood v. May*, 73 Wash. 2d 307, 310, 438 P.2d 587 (1968) (upholding 5-year, 100-mile restriction on a horseshoer).

*Pacific Aerospace & Electronics, Inc. v. Taylor*, 295 F. Supp. 2d 1205 (E.D. Wash. 2003) (upholding covenant barring senior engineer from "directly or indirectly" contacting former employer's customers for 2 years after termination, or for 6 months if employee was terminated for cause).

*Seabury & Smith v. Payn Fin. Group, Inc.*, 393 F. Supp. 2d 1057 (E.D. Wash. 2005) (finding a 1-year restrictive covenant covering clients and prospective clients of former employer who were solicited or serviced during the employee's term of service to be reasonable and enforceable).

#### B. Ancillary to the sale of a business:

Under Washington law, covenants not to compete in the franchise context "are evaluated under the same standards as covenants in the employment context." *HomeTask Handyman Serv., Inc. v. Cooper*, 2007 U.S. Dist. LEXIS 84708, \*9 (D. Wash. 2007) (modifying 2-year non-compete

restricting a former handyman service franchisee from operating a home repair business within 100-mile “buffer zone” and limiting to 25 miles of former franchisee territory).

In the context of a noncompete provision that precluded competition in the city of Vancouver, the court found that the seller’s opening of a competing business just outside the city limits could reasonably be interpreted to be a violation of the covenant. *Rippe v. Doran*, 4 Wn. App. 952, 486 P.2d 107 (1971).

### III. GENERAL COMMENTS

#### A. Protectable Interest:

1. *Wood v. May*, 73 Wn. 2d 307, 310, 438 P.2d 587 (1968) (“It is clear that if the nature of the employment is such as will bring the employee in personal contact with the patrons or customers of the employer, or enable him to acquire valuable information as to the nature and character of the business and the names and requirements of the patrons or customers, enabling him, by engaging in a competing business in his own behalf, or for another, to take advantage of such knowledge of or acquaintance with the patrons or customers of his former employer, and thereby gain an unfair advantage, equity will interfere in behalf of the employer and restrain the breach of a negative covenant not to engage in such competing business”).
2. *Pacific Aerospace & Electronics, Inc. v. Taylor*, 295 F. Supp. 2d 1205, 1216-17 (E.D. Wash. 2003) (non-solicitation provision reasonably protects employer from immediate competition from employee who was given access to customers’ internal operations and business relationships).
3. However, Washington courts have found that a covenant not to compete is not necessary “to protect a business from the advantage a former short-time employee may have by reason of the skills and training acquired during his or her employment.” *Copier Specialists, Inc. v. Gillen*, 76 Wn. App. 771, 774 (1995) (holding that the training a photocopy repairman acquired during employment, without more, did not warrant enforcement of a restrictive covenant where he was terminated after 6 months of employment, had “very limited contact” with customers, and “there were no client lists to protect”).

#### B. Customer restriction: *Perry v. Moran*, 109 Wn. 2d 691, 748 P.2d 224, 230 (1987) (upholding covenant restricting former employee from

performing accounting work for former clients for a reasonable time and within a reasonable territory); *Knight, Vale & Gregory v. McDaniel*, 37 Wn. App. 366, 680 P.2d 448 (1984) (covenant enforceable with respect to restrictions on working for former clients of the employer with whom former employees had come into contact as a consequence of their employment); *Alexander & Alexander v. Wohlman*, 19 Wn. App. 670, 578 P.2d 530 (1978) (enforcing covenant to preclude solicitation and diversion of customers within greater Seattle area for a 2-year period); *Pacific Aerospace & Electronics, Inc. v. Taylor*, 295 F. Supp. 2d 1205 (E.D. Wash. 2003) (upholding covenant barring senior engineer from “directly or indirectly” contacting former employer’s customers for 2 years after termination, or for 6 months if employee was terminated for cause).

**C. Blue pencil/modification:** Washington courts “will enforce covenants to the extent it is reasonable.” *Wood v. May*, 73 Wn. 2d 307, 312-313, 438 P.2d 587 (1968). A court may impose partial enforcement of an otherwise defective covenant where doing so is possible without injury to the public and without injustice to the parties. *Sheppard v. Blackstock Lumber Co., Inc.*, 85 Wn. 2d 929, 934, 540 P.2d 1371 (1975); see also *Armstrong v. Taco Time Int’l*, 30 Wn. App. 538, 635 P.2d 1114 (1981) (finding 5-year nation-wide covenant unreasonable in time and geographic scope, and therefore limited to 2.5 years and within an area covered by the franchise agreement or any other franchise agreement); *HomeTask Handyman Services, Inc v. Cooper*, 2007 U.S. Dist. LEXIS 84708, \*11-13 (D. Wash. 2007) (modifying 100-mile geographic restriction to apply only over 25-mile area).

**D. Consideration:**

1. The general rule in Washington is that consideration exists if the employee enters into a non-compete agreement when he or she is first hired. *Wood v. May*, 73 Wn.2d 307, 310-11, 438 P.2d 587 (1968); see also *Racine v. Bender*, 141 Wash. 606, 609, 252 P. 115 (1927); *Knight, Vale & Gregory v. McDaniel*, 37 Wn. App. 366, 368, 680 P.2d 448 (1984).
2. A noncompete agreement entered into *after* employment commences will be enforced only if it is supported by independent consideration. *Rosellini v. Banchemo*, 83 Wn.2d 268, 273, 517 P.2d 955 (1974); *Schneller v. Hayes*, 176 Wn. 115, 118, 28 P.2d 273 (1934). Independent consideration involves new promises or obligations previously not required of the parties, and may include increased wages, a promotion, a bonus, a fixed term of employment, or perhaps access to protected information. *Schneller*, 176 Wash. at 118-19.

3. Continued employment will generally not provide sufficient consideration to support a covenant not to compete entered into after the employment relationship has begun. *Labriola v. Pollard Group, Inc.*, 152 Wn. 2d 828 (2004). The Washington Supreme Court held in *Labriola* that “independent consideration is required at the time promises are made for a noncompete agreement when employment has already commenced.” *Id.* at 838. Independent consideration involves new promises or obligations previously not required of the parties. Although continued employment or training may serve as sufficient consideration in some cases, it was held to be insufficient by the court in *Labriola* where the employee signed only one subsequent noncompete agreement almost 5 years after beginning his employment and received no new benefits or training in exchange beyond what he was entitled to under his original employment agreement.

The Court in *Labriola* distinguished *Racine v. Bender*, 141 Wash. 606, 252 P. 115 (1927), finding that a warranty not to compete signed by the employee on a weekly basis for 260 consecutive weeks created a valid contract. In *Racine*, at the time of hire, the parties made no mention of restrictions on the employee’s future employment. However, at the end of each week during the employment, the employee was required to prepare a report and sign a warranty agreeing not to compete against the company for three years after the conclusion of his employment. *Racine v. Bender*, 141 Wn. at 607. In upholding the covenant, the court in *Racine* reasoned as follows:

[W]hen each week [the employee] signed the warranty which expressly provides in the first three provisions in words that no man may misunderstand, "(a) my entire time shall be devoted; (b) during such employment I shall not do[;] and (c) either during or after leaving such employment I will not take any action," such a warranty contained in each report was certainly a basis and a part consideration for future employment.

*Id.* at 609. Although signed after the completion of one week's worth of work, the warranty not to compete signed by the employee served as consideration for future employment based upon the conduct of the parties each week for 260 weeks.

- E. **Enforceability of “clawbacks” and other forfeitures of benefits:** The validity of a non-compete clause that affects the forfeiture of retirement benefits is determined based on the same reasonableness test as non-

competition clauses in employment contracts. *Sheppard v. Blackstock Lumber Co.*, 85 Wn. 2d 929, 540 P. 2d 1373 (1975).

- F.** Will an employer's breach of the employment agreement relieve the employee of his obligation not to compete?

Where an employer's termination of the employee constitutes a breach of the employment contract, the restrictive covenant may not be enforced. *Comfort & Fleming Ins. Brokers v. Hoxey*, 26 Wn. App. 172, 613 P.2d 138 (1980) (refusing to enforce restrictive covenant where the employee's written contract precluded termination except for good cause, and where the employee was fired without good cause); see also *Parsons Supply v. Smith*, 22 Wn. App. 520, 523 591 P.2d 821, 823 (1979) (noting that generally "a breaching party cannot demand performance from the nonbreaching party").

- G. Will a choice of law provision in a contract be followed?**

Generally yes. Washington courts generally will give effect to an express choice of law clause unless application of the law of the chosen state would be contrary to a fundamental policy of Washington and Washington has a materially greater interest in the determination of the particular issue. *O'Brien v. Shearson Hayden Stone, Inc.*, 90 Wash. 2d 680, 685-86, 586 P.2d 830 (1978) (did not involve a covenant not to compete).

- H. Trade secrets defined:** Uniform Trade Secrets Act, Wash. Rev. Code Ann. § 19.108.010, et. seq.

- I. Protection of confidential or trade secret information (absent a non-compete)?**

A former employee, "even in the absence of an enforceable covenant not to compete, remains under a duty not to use or disclose, to the detriment of the former employer, trade secrets acquired in the course of previous employment [with that employer]. Where the former employee seeks to use the trade secrets of the former employer in order to obtain a competitive advantage, then competitive activity can be enjoined or result in an award of damages" *Ed Nowogroski Ins., Inc. v. Rucker*, 137 Wn. 2d 427, 437, 971 P. 2d 936 (1999).

## WEST VIRGINIA

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## WEST VIRGINIA

### I. JUDICIAL STATEMENT OF THE LAW

A restraint is reasonable only if it (1) is no greater than is required for the protection of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public. *Reddy v. Community Health Found. of Man*, 298 S.E.2d 906, 911 (W. Va. 1982) (citing *Harlan Blake, Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 648 (1960)).

To be inherently reasonable under West Virginia law, the time or area limitations of a covenant not to compete "must not be excessively broad and the covenant must not be designed to intimidate employees rather [than] protect the employer's business." *Del Giorno v. Gateway Reg'l Health Sys., Inc.*, 64 F.Supp.2d 604, 606 n.2 (N.D. W.Va. 1999) (dicta; not a covenant case).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract.

1. *Huntington Eye Assocs., Inc. v. LoCascio*, 553 S.E.2d 773 (W.Va. 2001) (restriction of 2 years, 50 miles from any of former employer's offices "not facially unreasonable"); *Gant v. Hygeia Facilities Found., Inc.*, 384 S.E.2d 842 (W. Va. 1989) (three-year, thirty-mile radius restriction was reasonable); *Appalachian Labs., Inc. v. Bostic*, 359 S.E.2d 614 (W. Va. 1987) (restraint covering five-years, ten-county region where employer conducts business found reasonable, but covenant not enforced where employer's customer list was readily available from independent sources); *Reddy*, 298 S.E.2d 906 (three-year, thirty-mile radius restriction found reasonable); *Wycoff v. Painter*, 115 S.E.2d 80 (W. Va. 1960) (one-year, statewide restriction found reasonable); *Chicago Towel Co. v. Reynolds*, 152 S.E. 200 (W. Va. 1930) (five-year, any city where employee worked for employer restriction found reasonable).
2. *Moore Bus. Forms, Inc. v. Foppiano*, 382 S.E.2d 499, 502 (W. Va. 1989) (restrictive covenant will not be enforced where employee lacks specialized skills and customer information is readily available from other services); *McGough v. Nalco, Co.*, 496 F. Supp. 2d 729, 755 (N.D.W. Va. 2007) (holding that a two-year, nationwide covenant not to compete was unreasonable on its face because the geographic area was too large and refusing to "blue-pencil" the covenant because it was facially unreasonable). *Pancake Realty Co. v. Harber*, 73 S.E.2d 438 (W. Va. 1952) (one-year, everywhere restriction was void and unenforceable); *O. Hommel Co., Inc. v. Fink*, 177 S.E. 619, 620 (W. Va. 1934) (three-year restriction covering Canada and the

portion of the United States east of the Mississippi was enforced only as to those states and provinces in which the employer operated).

**B. Incidental to the sale of a business.**

1. *Axford v. Price*, 61 S.E.2d 637, 640 (W. Va. 1950) (restriction unlimited as to time found enforceable to the extent necessary for the protection of plaintiff's business).
2. *Huddleston v. Mariotti*, 102 S.E.2d 527 (W. Va. 1958) (ten-year, ten-mile covenant not to "engage" in the hotel business did not prevent sellers of hotel from constructing a hotel within close proximity to the sold hotel because the newly constructed hotel was to be sold to a third party before operation).

**III. GENERAL COMMENTS**

- A. Protectable interests: Confidential information unique to an employer, including customer lists and trade secrets, *Reddy*, 298 S.E.2d 906; *Gant*, 384 S.E.2d at 846 (goodwill).
- B. If a covenant is overbroad, but not lacking in, consideration, it may be "blue-penciled" and enforced to the extent necessary, but courts should be reluctant to "blue-pencil" if such action will produce a tendency to overreach in future cases. See *Reddy*, 298 S.E.2d at 914-15.
- C. Continued employment is probably not sufficient consideration for a non-competition agreement. See *Envtl. Prods. Co. v. Duncan*, 285 S.E.2d 889, 890 (W. Va. 1982); *Pemco Corp. v. Rose*, 257 S.E.2d 885, 889 (W. Va. 1979) (applying Virginia law); *McGough*, 496 F. Supp. 2d at 746.
- D. Will a choice of law provision in contract be followed? West Virginia courts have not addressed the issue of choice of law provisions in covenant not to compete cases. However, choices of law provisions in contracts generally have been upheld unless: (1) the chosen state has no substantial relationship to the parties to the transaction or (2) the application of the law of the chosen state would be contrary to the fundamental policy of the state whose law would apply in the absence of a choice of law provision. See, e.g., *Nadler v. Liberty Mut. Fire Ins. Co.*, 424 S.E.2d 256, 261 n.8 (W. Va. 1992); *Bryan v. Massachusetts Mut. Life Ins. Co.*, 364 S.E.2d 786 (W. Va. 1987).
- E. Injunctive relief to enforce a covenant not to compete is available if the covenant protects a legitimate business interest of the employer and it does not impose an undue hardship on the employee. *Merrill Lynch*,

*Pierce, Fenner & Smith, Inc. v. Coffindaffer*, 183 F.Supp.2d 842, 852 (N.D. W.Va. 2000).

- F. Trade secrets defined: *Reddy*, 298 S.E.2d at 912.
- G. Noteworthy articles and/or publications: (a) Walt Auvil, *Covenants Not to Compete*, 2001 W. Va. Lawyer 20 (Nov. 2001); (b) Note, *Employment Restrictive Covenants (Survey of Developments in West Virginia Law 1983)*, 86 W. Va. L. Rev. 574 (1983).
- H. Noteworthy case summarizing scope of permissible/ impermissible restraints: *Reddy*, 298 S.E.2d 906.

## WISCONSIN

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## WISCONSIN

### I. LEGISLATIVE/JUDICIAL STATEMENTS OF THE LAW

#### A. Covenants ancillary to an employment contract:

Wis. Stat. Ann. § 103.465 (1988) provides:

A covenant by an assistant, servant, or agent not to compete with his employer or principal during the term of the employment or agency, or thereafter, within a specified territory and during a specified time is lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer or principal. Any such restrictive covenant imposing an unreasonable restraint is illegal, void and unenforceable even as to so much of the covenant or performance as would be a reasonable restraint.

In addition, restrictive covenants in employments are also subject to common law contract principles requiring that a contract be supported by consideration. *NBZ, Inc. v. Pilarski*, 185 Wis. 2d 827, 520 N.W.2d 93, 94 (Wis. Ct. App. 1994) (finding covenant unenforceable for lack of consideration). However, a promise of initial employment is sufficient consideration for a restrictive covenant even if the employment is at will. *Id.* at 96 n. 4.

#### B. Covenants ancillary to the sale of a business:

In determining the reasonableness of a covenant incidental to the sale of a business, Wisconsin courts examine "whether the covenant is (1) reasonably necessary for the protection of the beneficiary; (2) reasonable as between the parties and particularly as to the party restrained, considering time, space, purpose, and scope; and (3) not specially injurious to the public." *Reiman Assoc., Inc. v. R/A Advertising Inc.*, 102 Wis. 2d 305, 306 N.W.2d 292, 295 (Wis. Ct. App. 1981).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Covenants Ancillary to an employment contract:

A valid restrictive covenant not to compete after a term of employment must be reasonably necessary for the protection of legitimate business interests of the employer and should not be oppressive and harsh on the employee or injurious to the interests of the general public. *Rollins Burdick Hunter of Wis. v. Hamilton*, 101 Wis. 2d 460, 304 N.W.2d 752 (Wis. 1981). The restraints imposed on the employee must be reasonably limited in terms of geographic area or time. *Gary Van Zeeland Talent, Inc. v. Sandas*, 84 Wis. 2d 202, 267 N.W.2d 242 (Wis. 1978).

There are no flat rules of reasonableness for restrictive covenants, *Fields Found. v. Christensen*, 103 Wis. 2d 465, 309 N.W.2d 125, 132 (Wis. Ct. App. 1981), and the determination as to whether particular restrictions as to time and area are reasonable is a question of law to

be resolved on the basis of the facts. *Geocaris v. Surgical Consultants*, 100 Wis. 2d 387, 388, 302 N.W.2d 76,77-78 (Wis. Ct. App. 1981).

As a practical matter, Wisconsin courts have consistently upheld covenants restricting competition for one or two years after the termination of employment. See, e.g., *Farmers Ins. Exhc. v. Sorenson*, 99 F. Supp. 2d 1000, 1007 (E.D. Wis. 2000) (one year restriction enforceable); *Pollack v. Calimag*, 157 Wis. 2d 222, 45 N.W.2d 591 (Wis. Ct. App. 1990) (one year restriction enforceable); *Fields Found. v. Christensen*, 103 Wis.2d 465, 309 N.W.2d 125 (Wis. Ct. App. 1981) (two years found reasonable).

A restrictive covenant generally must be limited geographically to the area in which the employer does business. *Pollack*, 458 N.W.2d at 599 (upholding covenant imposing restriction in 20-mile radius from medical clinic because advertising generated numerous patients from within a 20-mile radius); *Fields Found.*, 309 N.W.2d at 132 (upholding covenant imposing restriction in 50-mile radius where employer obtained 62 percent of its business from that area).

A covenant which restricts competition by customers, rather than geographically, is valid in Wisconsin. *Chuck Wagon Catering Inc. v. Raduege*, 88 Wis.2d 740, 277 N.W.2d 787, 793 (Wis. 1979); *Rollins Burdick Hunter v. Hamilton*, 101 Wis. 2d 460, 304 N.W.2d 752, 755-56 (Wis. 1981).

However, a covenant that lacks any temporal or geographic limitation is unreasonable and void. *Gary Van Zeeland Talent, Inc. v. Sandas*, 84 Wis.2d 202, 267 N.W.2d 242, 250 (Wis. 1978). In addition, agreements that constitute nationwide prohibitions where the employer's business was not nationwide have been found unenforceable. See, e.g., *Union Central Life Ins. Co. v. Balistreri*, 19 Wis.2d 265, 120 N.W.2d 126 (Wis. 1963) (agreement that effectively prohibited the former employee from competing anywhere in the United States, when he had only worked in one county, was unenforceable); *Equity Enters., Inc. v. Milosch*, 247 Wis. 2d 172, 178-79, 633 N.W.2d 662, 666 (Wis. Ct. App. 2001) (court found language of restriction to be "functionally equivalent" to nationwide restriction and therefore overly broad); *Behnke v. Hertz Corp.*, 70 Wis. 2d 818, 235 N.W.2d 690 (Wis. 1975) (territorial restriction covering all of Milwaukee geographically overbroad and invalid when employer's sole place of business was located at the Milwaukee airport).

If there is no protectable interest, the courts will not enforce the agreement even if the time and geographic restrictions are reasonable. See, e.g., *NBZ, Inc. v. Pilarski*, 185 Wis. 2d 827, 520 N.W.2d 93 (Wis. Ct. App. 1994)(1-year, 5-mile covenant not to compete was not reasonably necessary for the protection of an employer's interests where employer – a hair salon studio – did not execute covenants in a systematic manner, employee's relationships with employer's customers corresponded to only 2 percent of employer's gross revenues, and employee's new employment did not render former employer unable to compete).

**B. Ancillary to the sale of a business:**

Wisconsin courts will allow for more expansive restrictions when the restrictive covenant is incidental to the sale of a business. See, e.g., *Reiman Assoc., Inc. v. R/A Advertising, Inc.*, 102 Wis. 2d 305, 306 N.W.2d 292, 296 (Wis. Ct. App. 1981) (where defendant produced ads for one of plaintiff's six publications, court enforced non-compete for six years limited to that publication); *General Bronze Corp. v. Schmeling*, 208 Wis. 565, 243 N.W. 469 (Wis. 1932) (enforcing 15-year non-compete throughout United States, although court struck provisions restricting competition in Mexico and Canada under "blue pencil" doctrine, as plaintiff had done no business in either country).

**III. GENERAL COMMENTS**

**A. Protectable interests:**

Wisconsin courts will enforce covenants to protect goodwill, customer relationships, trade secrets, and business-related information. *Pollack v. Calimag*, 157 Wis. 2d 222, 45 N.W.2d 591, 598-99 (Wis. Ct. App. 1990) (employer's stock of patients); *Chuck Wagon Catering, Inc. v. Raduege*, 88 Wis.2d 740, 277 N.W.2d 787, 792 (Wis. 1979) (customer relationships; goodwill); *Fields Found. v. Christensen*, 103 Wis.2d 465, 309 N.W.2d 125, 129 (Wis. Ct. App. 1981) (customer relationships; business information; trade secrets); *Rollins Burdick Hunter v. Hamilton*, 101 Wis.2d 460, 304 N.W.2d 752 (Wis. 1981) (business information); *Lakeside Oil Co. v. Slutsky*, 8 Wis. 2d 157, 98 N.W.2d 415 (Wis. 1959) (customer relationships); *General Bronze Corp. v. Schmeling*, 208 Wis. 565, 243 N.W. 469, 471 (Wis. 1932) (goodwill); but see *Wausau Medical Center, S.C. v. Asplund*, 182 Wis. 2d 274, 415 N.W.2d 34 (Wis. Ct. App. 1994) (while referral contacts, reputation enhancement, and unique skills acquired through employment with covenantor could constitute legitimate protectable interests, court found no such interests to exist where employee surgeon only employed for three-and-one-half months).

**B. Severability /Modification of Overly Broad Restrictions:**

Under Wisconsin law, if a restrictive covenant in the employment context is overbroad, the covenant is void. Wis. Stat. Ann. § 130.465; *Lakeside Oil Co. v. Slutsky*, 8 Wis. 2d 157, 98 N.W.2d 415, 419 (Wis. 1959); *General Med. Corp. v. Kobs*, 179 Wis. 2d 422, 507 N.W.2d 381, 385 (Wis. Ct. App. 1993).

Although one Wisconsin court appeared to hold that § 130.465 only prohibited the modification of language in the contract (as opposed to striking overly broad provisions and enforcing the remaining provisions), *Streiff v. American Family Mut. Ins. Co.*, 118 Wis. 2d 602, 348 N.W.2d 505 (Wis. 1984), subsequent decisions have held that § 130.465 goes further to prohibit the striking, or "blue penciling," of provisions that are severable from the rest. *General Med. Corp. v. Kobs*, 179 Wis. 2d 422, 507 N.W.2d 381, 385 (Wis. Ct. App. 1993). Thus, any unreasonable portion of the covenant not to compete voids the entire covenant even if severable portions exist that would

otherwise be enforceable. *Wausau Medical Center, S.C. v. Asplund*, 182 Wis. 2d 274, 415 N.W.2d 34 (Wis. Ct. App. 1994); *General Medical Corp. v. Kobs*, 179 Wis. 2d 422, 507 N.W.2d 381 (Wis. Ct. App. 1993).

In contrast to covenants in the employment context, “covenants incidental to the sale of a business benefit from full application of the rule of partial enforcement: Even an unreasonable-restraint will be enforced to the extent necessary and reasonable under the circumstances.” *Reiman Assoc., Inc. v. R/A Advertising, Inc.*, 102 Wis. 2d. 305, 306 N.W.2d 292, 295-96 (Wis. Ct. App. 1981) (citing *Fullerton Lumber Co. v. Torbora*, 270 Wis. 133, 142-48, 70 N.W.2d 585, 589-92 (Wis. 1955)).

**C. Continued Employment as Consideration:**

Wisconsin courts have not clearly addressed whether continued employment is sufficient consideration for a covenant not to compete in the employment context. However, restrictive covenants are subject to common law contract principles requiring consideration for the covenant. One court opined that continued employment will not provide sufficient consideration to support a covenant not to compete, at least where there is no indication that the former employer conditioned continued employment or promised to do anything in exchange for the employee’s signing the covenant. *NBZ, Inc. v. Pilarski*, 185 Wis. 2d 827, 520 N.W.2d 93, 97 (Wis. Ct. App. 1994). However, that court did not say that continued employment could *never* suffice as consideration for a restrictive covenant, and the issue remains open under Wisconsin law.

- D.** A forfeiture of benefits provision is treated as a restraint of trade and thus is subject to the same analysis as other noncompetition covenants. See, e.g., *Streiff v. American Family Mut. Ins. Co.*, 118 Wis.2d 602, 348 N.W.2d 505, 510 (Wis. 1984) (invalidating provision that insurance agent would forfeit "extended earnings" if agent competed after termination of employment); *Union Central Life Ins. Co. v. Balistrieri*, 19 Wis. 2d 265, 120 N.W.2d 126, 129 (Wis. 1963) (invalidating requirement to repay the excess of advances over credit).
- E.** Attorneys' fees appear to be recoverable under Wisconsin law for breach of a noncompete agreement if the contract so provides. See, e.g., *Klinefelter v. Dutch*, 161 Wis. 2d 28, 467 N.W.2d 192, 196 (Wis. Ct. App. 1991) (“a prevailing litigant is not entitled to collect attorney fees from the opposing party, *absent contractual or statutory provisions authorizing recovery*” (emphasis added)); *Watkins v. Labor and Industry Review Common*, 117 Wis. 2d 753, 345 N.W.2d 482 (Wis. 1984) (same). However, Wisconsin courts have not considered this question other than in dicta in the noncompete context.
- F.** Wisconsin has adopted the Uniform Trade Secrets Act, with some modifications. Wis. Stat. Ann. § 134.90. Thus, attorneys' fees are

recoverable in the circumstances set out in § 4 of the UTSA, including willful and malicious misappropriation of a trade secret.

Wisconsin has adopted the Uniform Trade Secret Act's definition of a trade secret as "information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (1) derives independent economic value actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." Wis. Stat. Ann. § 134.90.

- G. An employer's substantial or material breach of the employment agreement will relieve the employee of contractual obligations not to compete. A material breach of contract discharges the nonbreaching party from any obligation. The breaching party may not sue on the contract. *Jolin v. Oster*, 55 Wis. 2d 199, 198 N.W.2d 639, 647 (Wis. 1972). To be material, the breach must be substantial and sufficiently serious to destroy the essential purpose of the contract. *Appleton State Bank v. Lee*, 33 Wis. 2d 690, 148 N.W.2d 1, 2-3 (Wis. 1967).
- H. It is a long-standing rule in Wisconsin that parties can "expressly" state a choice of law provision in contract choosing which state's law will apply to their contractual relationship. See *Bush v. Nat'l School Studios, Inc.*, 139 Wis. 2d 635, 642-43, 407 N.W.2d 883, 886-87 (Wis. 1987). However, it is likely that a Wisconsin court would not honor a choice of law clause in an employment-related noncompete agreement if the noncompete agreement would be unenforceable under Wisconsin law. *General Med. Corp. v. Kobs*, 179 Wis. 2d 422, 428, 507 N.W.2d 381, 383-84 (Wis. Ct. App. 1993). Generally, Wisconsin courts will honor a choice of law clause unless (1) the parties have no substantial relationship to the chosen state or there is no reasonable basis to choose that state, or (2) the chosen state's law is contrary to Wisconsin public policy. *Sersted v. American Can Co.*, 535 F. Supp. 1072, 1078 (E.D. Wis. 1982). In *Bush v. Nat'l School Studios, Inc.*, 139 Wis.2d 635, 407 N.W.2d 883, 886 (Wis. 1987), the court stated in dicta that "laws prohibiting covenants not to compete . . . are likely to embody an important state policy." As noted in Section I, *supra*, Wisconsin has a statute restricting noncompete agreements in the employment context.
- I. The state's Code of Professional Responsibility imposes restrictions on the enforcement of covenants not to compete within the legal profession.
- J. Noteworthy articles and/or publications: Nettesheim & Broomfield, Restrictive Covenants and the Wisconsin Service Professional, 66 Wis. Law. 20 (Feb. 1993); Nettesheim, Drafting Enforceable Covenants Not to Compete, 59 Wis. B. Bull. 29 (Oct. 1986); Olson, Restrictive

Covenants in Wisconsin Employment Contracts, 53 Wis. B. Bull. 24 (March 1980); Richards, Drafting and Enforcing Restrictive Covenants Not to Compete, 55 Marq. L. Rev. 241 (1972).

- K. Noteworthy cases summarizing the scope of permissible/impermissible restraints: *Streiff v. American Family Mut. Ins. Co.*, 118 Wis. 2d 602, 348 N.W.2d 505, 510 (Wis. 1984); *Reiman Assoc., Inc. v. R/A Advertising, Inc.*, 102 Wis. 2d 305, 306 N.W.2d 292, 295 (Wis. Ct. App. 1981); *Fields Found. v. Christensen*, 103 Wis.2d 465, 309 N.W.2d 125 (Wis. Ct. App. 1981); *Chuck Wagon Catering, Inc. v. Raduege*, 88 Wis.2d 740, 277 N.W.2d 787 (Wis. 1979); *Wausau Medical Center, S.C. v. Asplund*, 182 Wis. 2d 274, 415 N.W.2d 34 (Wis. Ct. App. 1994).

## **WYOMING**

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## WYOMING

### I. STATUTORY AUTHORITY

Wyoming has no statute governing the enforceability or reasonableness of covenants not to compete.

### II. JUDICIAL STATEMENTS OF THE LAW

"[T]he legitimate interests of the employer . . . which may be protected from competition include: a) the employer's trade secrets which have been communicated to the employee during the course of employment; b) confidential information communicated by the employer to the employee, but not involving trade secrets, such as information on a unique business method, and; c) special influence by the employee obtained during the course of employment over the employer's customers." *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 540 (Wyo. 1993). However, an employer is not entitled to protection against ordinary competition. See *id.* Covenants not to compete are sustained if they "are no wider than reasonably necessary for the protection of the employer's business, and do not impose the undue hardship on the employee, due regard being had to the interest of the public." *Ridley v. Krout*, 180 P.2d 124, 127 (1947). The employer has the burden to prove the covenant is fair, reasonable and necessary for the protection of the employer's business. See *Tench v. Weaver*, 374 P.2d 27, 29 (Wyo. 1962).

### III. ENFORCEABILITY

- A. "A valid and enforceable covenant not to compete requires a showing that the covenant is: a) in writing; b) part of a contract for employment; c) based on reasonable consideration; d) reasonable in duration and geographical limitations; and e) not against public policy." *Hopper* at 540.
- B. The signing of a covenant not to compete at the inception of the employment relationship provides sufficient consideration to support a covenant not to compete. See, e.g., *Hopper* at 541. However, the Wyoming Supreme Court has analyzed such agreements in terms of whether the covenant not to compete is ancillary to an otherwise enforceable agreement. *Id.*
- C. A change in the terms and conditions of employment will provide sufficient consideration to support a covenant not to compete entered into after the employment relationship has begun. *Id.*
- D. Continued employment alone will not provide the necessary consideration to support a covenant not to compete entered into after the employment relationship has already begun. Instead, separate

consideration, such as a change in the terms and conditions of employment, must be given contemporaneously with the making of the covenant. This requirement apparently applies whether the employment is at-will or not. *Id.*

- E. For at-will employees, the employer must terminate the employment relationship in good faith; otherwise, any covenant not to compete is unenforceable. *Id.* According to the Wyoming Supreme Court, “[s]imple justice requires that a termination by the employer of an at will employee be in good faith” if a covenant not to compete is to be enforced. *Id.*; see also *Dutch Maid Bakeries v. Schleicher*, 131 P.2d 630, 635 (Wyo. 1942) (“an injunction to enforce the ancillary promise of the employee not to compete with the employer may be denied on the ground that the conduct of the employer in discharging the employee without just or adequate cause is ‘savored with injustice’”).

#### IV. PARAMETERS OF THE “REASONABLENESS” TEST

To enforce a covenant not to compete, the moving party must show the restrictions on the former employee are reasonable. The reasonableness determination regarding the type of activity, geography and durational restrictions is made on a case-by-case basis. *Hopper* at 543 (Wyo. 1993). In *Hopper*, the Wyoming Supreme Court reaffirmed its adherence to the “rule of reason inquiry” contained in Restatement (Second) of Contracts, § 188 and noted that the essence of the rule was that “a restraint is reasonable only if it (1) is no greater than is required for the protection of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public.” *Hopper* at 539 (citation omitted).

Numerous factors for evaluating reasonableness were set out in *Hopper*. Such factors to be balanced may include: the degree of inequality in bargaining power; risk of the promisee losing customers; extent of participation by the parties in securing and retaining customers; good faith of promisee; general knowledge regarding the identity of customers; nature and extent of business position held by the promisor; promisor’s training, health, education, and needs of family; current conditions of employment; need for promisor to change residence or professions; and the correspondence of the restraint with the need for protecting the legitimate interests of the promisee. *Hopper* at 540 (citation omitted).

##### A. Reasonableness test applied:

1. *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 544-545 (Wyo. 1993) (one year restriction on competing business, revised by court down from three years, within a five mile radius from city’s corporate limits was enforceable).

2. *Mott v. England*, 604 P.2d 560, 561 (Wyo. 1979) (covenant in employment contract prohibiting practice of medicine in Jackson, Wyoming was enforceable).
3. *Ridley v. Krout*, 180 P.2d 124, 126-133 (Wyo. 1947) (seven year duration and three county limitation in covenant not to compete were unreasonable and held unenforceable).
4. *Dutch Maid Bakeries v. Schleicher*, 131 P.2d 630, 635-636 (Wyo. 1942) (a 5-year covenant not to compete in employer's trade territories held unreasonable based on employer's unclean hands).
5. *Tench v. Weaver*, 374 P.2d 27, 29 (Wyo. 1962) (covenant not to compete held unreasonable where former employee left private practice to work for the federal government; employer could not demonstrate that covenant was "necessary for the protection of his business").

## V. GENERAL COMMENTS

### A. Protectable interests include:

1. Trade secrets and confidential information communicated to the employee by the employer during the course of employment. See *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 540 (Wyo. 1993).
2. Special influence by the employee over the employer's customers obtained during the course of employment. See *Dutch Maid Bakeries v. Schleicher*, 131 P.2d 630, 635 (Wyo. 1942).
3. The sale of good will. *Ridley v. Krout*, 180 P.2d 124, 129 (Wyo. 1947).

**B.** If the covenant is overbroad, it can be equitably modified. *Hopper* at 545-47. "We believe the ability to narrow the term of a covenant not to compete and enforce a reasonable restraint permits public policy to be served in the most effective manner." *Id.* at 546.

**C.** Noteworthy cases summarizing scope of permissible/impermissible restraints: *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531 (Wyo. 1993); *Tench v. Weaver*, 374 P.2d 27 (Wyo. 1962); *Ridley v. Krout*, 180 P.2d 124 (Wyo. 1947); *Dutch Maid Bakeries v. Schleicher*, 131 P.2d 630 (Wyo. 1942).

## VI. TRADE SECRETS

- A. Wyoming has not adopted the Uniform Trade Secrets Act.
- B. The Wyoming Supreme Court has recognized a common law cause of action for misappropriation of trade secrets and/or confidential information when former employees of a company are alleged to have misappropriated their former employer's trade secrets and/or confidential information to start a competing business. The elements of the cause of action are those contained in Restatement (Third) of Unfair Competition, supra, §§ 39 through 45. *Briefing.com v. Jones*, 126 P.3d 928, 936 (Wyo. 2006).

## BRAZIL

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## **BRAZIL**

### **I. BACKGROUND**

Labor relationships are highly regulated by Brazilian law and, consequently, contractual freedom between the employer and the employee is limited. The rights and duties of employers and employees are set out in the Federal Constitution, the Consolidated Labor Laws (CLT), collective bargaining agreements and collective labor conventions, as well as in some specific laws on certain matters.

Brazilian law, however, does not specifically address non-compete obligations in connection with labor relationships and legal precedents on the matter are still scarce.

### **II. NON-COMPETE CLAUSES**

The Brazilian Federal Constitution guarantees the freedom of work and for this reason, non-compete obligations may be construed as a limitation of a constitutional right. Accordingly, for the obligation to be deemed valid and enforceable under Brazilian law certain essential conditions must be complied with:

#### **A. Term**

It is necessary to define a reasonable and fixed term for the non-compete obligation. Although the law is silent on this regard, one or two years should be generally accepted by the courts. It is possible to negotiate a longer term depending on the position occupied by the employee and other specific characteristics of the case, but if a very long term is established, the non-compete obligation will be more exposed to challenges based on the abovementioned constitutional provision.

#### **B. Indemnification**

A reasonable compensation must be paid to the employee in consideration for the non-compete obligation. This payment must be treated as an indemnification to the employee and expressions like “salary” or “remuneration” must be avoided when referring to such payment. An indemnification equivalent to ½ to one monthly salary paid to the employee for each month of duration of the non-compete obligation is usually acceptable (for this purpose, only the “base salary”, excluding bonuses and other benefits paid to the employee, should be considered).

Although there is no rule on whether the indemnification must be paid in one lump sum or in installments, it is usually recommended to pay it

monthly or quarterly installments (or in any other periodicity) so that the payment can be interrupted if the employee ceases to comply with the obligation at any time. The non-compete clause must expressly provide for this possibility.

### **C. Geographic and business limitation**

The non-compete obligation must be limited to a defined geographic area and/or to a specific business. It is possible to establish that the obligation is valid throughout the Brazilian national territory and even expand it to other countries - this definition will very much depend on the area in which the company carries out its business. A clear and detailed definition of the business(es) in which the employee will not be allowed to act also helps to guarantee the validity and enforceability of the non-compete obligation.

## **III. OTHER ITEMS**

In addition to the conditions described above, other provisions may be included in non-compete clauses:

### **A. Penalty for breach**

In order to discourage the employee to breach the non-compete obligation, it is possible to establish a penalty to be paid by the employee in the event of non-compliance with his/her obligations. This penalty does not prevent the company from claiming supplementary damages in court, if this is the case, but the non-compete clause must expressly allow it to do so.

### **B. Release**

The non-compete clause may authorize the company to release the employee from the obligation, thereby also releasing the company from the payment of the corresponding indemnification. This condition gives the company more flexibility should it later determine that the non-compete obligation is not necessary. The employee could challenge this condition claiming that it is arbitrary and depends on the sole discretion of the company, but we understand the condition is defensible provided that it is expressly foreseen in the non-compete clause.

## FRANCE

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## FRANCE

(Last updated on December 1, 2008)

### I. BACKGROUND

Under French labor law, employer-employee relationships are highly regulated and, consequently, contractual freedom between the employer and the employee is severely restricted in comparison to American labor law. Two main sources that greatly affect labor relations are the Labor Code (*Code du Travail*) and collective bargaining agreements (*conventions collectives*), which are signed at the national level by both employers and employee trade unions for a given sector of activity.

When provisions on a given subject are contained in either the Labor Code and/or a collective bargaining agreement, the parties can only deviate from such principles if such deviation is more favorable to the employee.

### II. NON-COMPETITION CLAUSES

#### A. General principles of validity

The validity of non-compete clauses in employment contracts has been recognized by French courts. Such a clause is normally valid under the condition that the clause: (i) does not unduly restrict the ability of the employee to work in his or her field of expertise, and (ii) provides for the payment of financial compensation to the employee.

##### 1. No unlimited clauses

The determination of whether a clause is unduly restrictive is a question of fact that will be decided by the court assessing the validity of the non-compete clause. Generally, the court will examine whether the clause is limited:

- (a) in time, *i.e.*, there must be a limit on the period during which the affected employee cannot undertake an activity that competes with that of his or her former employer;<sup>8</sup> and
- (b) in space, *i.e.*, there must be a limit on the territory in which any competitive activity has been forbidden to the employee; and
- (c) with respect to the scope of the activities that may not be undertaken by the employee.

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<sup>8</sup> Most collective bargaining agreements provide that this period cannot exceed two years.

Even if a clause explicitly contains all of the above limits and is intended to protect the legitimate interests of the employer, the court nevertheless can further limit or cancel any such clause that in its opinion unduly restricts or effectively prohibits the ability of an employee to hold a job consistent with his or her professional training.

Moreover, certain collective bargaining agreements provide for specific limits on the duration of the non-compete obligation and the territory over which the non-compete obligation may be enforced.

## 2. Financial compensation

In addition to the above, a Supreme Court ruling in three separate decisions of July 10, 2002<sup>9</sup> now requires that all non-compete clauses provide for the payment of financial compensation as a condition to the validity of the clause. Such financial compensation is normally paid on a monthly basis to the employee during the entire period during which the non-compete clause is in effect. While these cases do not establish the amount of compensation that must be paid, they require that such compensation not be so ridiculously low as to be tantamount to an absence of compensation. The applicable collective bargaining agreement may contain a provision on the amount of the compensation, which is then compulsory. In most collective bargaining agreements, the amount of the financial compensation is a percentage of the remuneration received by the employee before the termination of his or her employment contract.

The employee is legally entitled to demand the payment of this compensation when the non-compete clause enters into force. No compensation therefore is due if the employer waives the non-compete clause, but such waiver should be expressly provided. Moreover, it can only take place after notice of termination of the contract has been given, and subject to the conditions and time limits contained in the applicable collective bargaining agreement, if any, or pursuant to the terms of the non-compete clause itself. In the absence of any provision relating to the time limit within which the waiver must be exercised, the employer may waive the non-compete clause at the latest on the date of termination of the employment

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<sup>9</sup> See Cass. Soc. July 10, 2002, n° 2723 FP-PBRI, Salembier v/ SA La Mondiale; Cass. Soc. July 10, 2002, n° 2724 FP-PBRI, Barbier v/ SA Maine Agri; Cass. Soc. July 10, 2002, n° 2725 FP-PBRI, Moline et autres v/ Société MSAS Cargo.

agreement.

The Supreme Court ruling of July 10, 2002 did not contradict previous cases pursuant to which clauses forbidding either the solicitation of customers or the hiring away of personnel by former employees do not require financial compensation. Presently, therefore, it appears these clauses are valid without financial compensation; however, the July 10, 2002 decisions could indicate a trend, and it is not impossible that within the next few years the Supreme Court could rule that financial compensation is required in these cases as well.

The July 10, 2002 ruling also would not apply to a covenant pursuant to which the seller of a business would undertake not to compete with the business being sold. This type of covenant would not be subject to labor law, but could be regulated under French competition law if the non-compete undertaking were to last more than three years.

## **B. Enforcement of the non-compete clause**

If the employer considers that the terms of the non-compete clause have been violated, the lawsuit would have to be brought initially before a Labor Court, which is composed of representatives of employers and employees, and whose decisions often favor employees. Appeals of decisions from the Labor Court are heard before the Court of Appeals, where decisions are normally unbiased.

If the employee is found to have violated the terms of a valid non-compete clause, the employee would be required by the court to reimburse any financial compensation received and/or pay damages to his or her former employer. The amount of damages due by the employee could also be set forth in a liquidated damages clause included in the employment agreement when the employee is hired. However, such liquidated damages clauses may be revised at the court's discretion according to the judge's assessment of the actual harm suffered by the employer.

## GERMANY

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## GERMANY

### I. SUMMARY OF THE LAW

Legal sources concerning the rules governing covenants not to compete are found in various laws and regulations depending on the subject matter of the respective covenant:

- A. During contractual relationships the duty not to compete derives from the statutory provision of the Commercial Code (*e.g.*, sec. 60, 112 HGB) and, in general, from the employee's loyalty obligation (German Federal Labor Court (BAG), in AP-No. 7 to § 611 BGB Treuepflicht) or the bona fide principles (sec. 242 Civil Law Code). In the noncompete context the latter requires that every partner to a contract has a duty of loyalty to each other.
  
- B. After termination of employment/agency/authorized dealer contracts the parties are free to compete with each other unless they have agreed on a noncompetition clause. Such covenants not to compete are legally valid only if they are in writing, contain a liability to pay compensation, serve rightful commercial interests and do not exceed two-years. In general- and this applies equally to self-employed persons, partners, associates, shareholders and to contracts in connection with the sale of a business - covenants not to compete are legally binding only if "demanded by interests warranting protection and being reasonable according to the local, temporal and concrete circumstances" (German Federal Court of Justice (BGHZ 91, 1)).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an employment contract:

1. The Prohibition of competition is only binding where the principal is obliged. for the term of the restriction, to pay annual compensation equal to at least one half of the most recent contractual remuneration received by the employee (sec. 74, para 2, German Commercial Code).
  
2. A noncompetition provision is not enforceable to the extent it does not serve to protect a legitimate business interest of the employer or is an unreasonable interference with the employee's career with respect to the compensation allowed, the place, time or subject matter (sec. 74 a, para 1 German Commercial Code), it may not run for more than two years after termination of the employment contract (sec. 74 a, para 1).

3. The employee's Obligation not to compete may be secured by a penalty clause (sec. 75 c, para 1 German Commercial Code).

**B. Incidental to the sale of business:**

1. The Prohibition of competition is only valid as far as the above (See Section I.) mentioned pre conditions are observed.

The maximum time limit of the restriction depends on the particular case (ten years upheld: timber trade business, BGH NJW 82, 2000; ten years not allowed: builder trade business, BGH NJW 79, 1605). Based on present case law, a covenant not to compete for a period of two years will, in most cases, be of the maximum permissible duration.

A covenant which restricts the purchaser for an unlimited period without local definition is unenforceable (cleaner's business: BGH NJW-RR 89, 800).

Also sec. 1, Act against restraints of competition in Germany, could be applicable if, and to the extent that, the covenant is not required to ensure, from a factual viewpoint, the consolidation of the business, including its goodwill, customer relations and know-how, in the hands of the purchaser (BGH NJW 1982, 2000).

**III. GENERAL COMMENTS**

- A.** An invalid covenant restraining an employee does not influence the validity of the whole contract as far as the parties would have closed the contract also without the invalid part. This cannot be taken as a general rule concerning self-employed persons (*e.g.*, BGH BB 1968, 60).
- B.** A covenant restraining competition of a self-employed person under a certain contract does not influence other activities of said person. For example, a leaseholder of a petrol Station who has an Obligation under his lease contract not to sell lubrication products other than those of the lessor/oil Company can sell other lubrication products in a garage which he is operating on his own account (BGH BB, 1968, 60). Additionally a restriction may be invalid if - for instance - regulating an insufficient compensation payment.
- C.** In the event of the routine termination of the contract through the employee, the restriction is put into force; in the event of the termination with good cause by the employee or a routine dismissal, the employee in principle has an Option to comply with the covenant or not.
- D.** If an employee violates the non-competition Obligation, the employer will be entitled to terminate the employment contract, usually without notice (BGH DB 1975, 1022 (Insurance agent)). If further competitive activities

are to be expected, the employee may be enjoined by preliminary injunction. The employer may also claim damages (sec. 61, para 1 German Commercial Code).

- E.** Attorneys' fees are recoverable in most cases where, *e.g.*, a violation of a covenant not to compete can be proved (sec. 91 ZPO).
- F.** A choice of law Provision in the contract will normally be upheld in cases where the parties have their principle places of business in different countries.
- G.** Sec. 310 para. 4, 305 Civil Law Code is applicable if the employment contract is based on a model contract that the employer uses for all employment contracts. In this case, the non-competition obligation could be *inter alia* considered as astonishing and therefore invalid.

## IRELAND

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## **IRELAND**

### **I. SUMMARY OF THE LAW**

Irish rules governing restrictive covenants are primarily found in the case law of the Irish courts. UK case law is also of persuasive (although not binding) value in this area.

Restrictive covenants are usually included in the contract of employment. There is no definitive rule of law as to enforceability or otherwise of restrictive covenants. In general terms, the Irish courts evaluate the competing interests of an employer's right to protect his business from unfair competition against the employee's freedom to work and the public interest in competition in the market place in order to determine whether such covenants are enforceable. Restrictive covenants will only be enforced by the Irish courts if they are not too oppressive or far reaching.

The most common types of restrictive covenants found in employment contracts are covenants which seek to restrain an employee from competing against the former employer, covenants which seek to restrain solicitation of employees and covenants which seek to restrain solicitation of customers. These covenants are considered in more detail below.

### **II. CONTRACTUAL TERMS**

**A.** Covenants in a contract of employment which restrain an employee's post employment activities will only be enforceable if the employer is in a position to show that the covenant (a) is drafted to protect a legitimate commercial interest capable of protection (the legitimate interest test) and (b) goes no further than necessary in order to protect that interest (the reasonableness test).

1. The Legitimate Interest Test Broadly speaking there are three types of interest which the Irish courts have recognized as capable of being protected by means of restrictive covenants, (i) customer connection, (ii) business intelligence and trade secrets and (iii) the existence of a stable workforce.

(a) Customer Connection

Customers and clients are a valuable business asset. If an employee has a close working relationship with customers or clients, there is a substantial risk that they may “follow” the employee should he move to a competitor or set up independently. The courts recognize that it is legitimate for the employer to try to prevent this. Cases in which a customer connection have been accepted to exist by the Irish courts include “*Oates —v — Romano*”<sup>1</sup> (a case involving a hairdresser) and “*Mulligan —v- Corr*”<sup>2</sup> (a case involving a solicitor).

An employer may attempt to protect its customer connection through either non-compete or non-solicitation covenants. In order to justify a restrictive covenant on the basis of customer connection, the employer must satisfy the Court that it seeks to protect a customer base, that the employee in question has direct exposure to its customers and is in a position to generate a tie with those customers and that the customers are in a position to divert business to the employee should he move elsewhere.

(b) Business Intelligence and Trade Secrets

Although the common law provides employers with a certain protection against the disclosure of confidential information or trade secrets by former employees, many employers rely on express non-compete covenants to strengthen this protection. The employer must establish that the information, by its nature, qualifies for protection by means of a restrictive covenant. The Courts will not allow an employer to prevent an employee from using the skill he ordinarily employs in his trade.

UK cases such as “*FSS Travel and Leisure Systems Ltd v. Johnson*”<sup>3</sup> are of note. In this case, the UK Court of Appeal held that the employee had not acquired all of the information contained in the computer programmes or the details of those programmes. He had merely increased his skill in working on such programmes. This was not an interest qualifying for protection as a trade secret.

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<sup>1</sup> (1950) 84 ILTR 161

<sup>2</sup> (1925) IR 169

<sup>3</sup> [1998] IRLR 382

(c) Existence of a stable work force

The goodwill between a business and its employees may also constitute an interest capable of protection by restrictive covenant. However, there is conflicting UK case law on this point.

In "*Hanover Insurance Brokers Ltd —v- Shapiro*"<sup>4</sup> the UK Court of Appeal rejected the proposition that employee stability was an interest capable of protection on the ground that it interferes with the right of those employees to work for whom they wish.

However, in "*TSC Europe --v- Massey*"<sup>5</sup> the UK Chancery Division accepted that the protection of an employer's employee base was a legitimate interest. However, the restrictive covenant in that case was held to be unenforceable because it applied to all employees of the company, even those who could not cause damage to the employer's commercial interests and to those who were employed by the employer following termination of the employee's employment and over whom the employee who have had no influence.

An employer may attempt to protect its workforce through non- solicitation covenants. These covenants must be confined to employees over whom the former employee has a hold or connection and to employees who are likely to pose a threat to the employer's commercial interests.

2. The Reasonableness Test

The restrictive covenant will not be enforceable unless it is reasonable in terms of (i) duration, (ii) geographical location and (iii) scope of the activities which may not be undertaken by the employee.

(a) Duration

In general, the Courts will not uphold non-compete or non-solicitation covenants which are for more than twelve months duration except in exceptional cases.

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<sup>4</sup> [1994] IRLR 82

<sup>5</sup> [1999] IRLR 22

Covenants which seek to prohibit solicitation of employees of the former employer must be limited to employees who were employed at the date of termination of employment and who were employed during the 6 months prior to termination of employment (although 12 months may be reasonable for senior executives or employees with a large degree of influence over employees or customers).

Covenants which seek to prohibit solicitation of customers of the former employer must be limited to customers who were customers at the date of termination of the employment and who were customers during the 6 months prior to termination of employment (although 12 months may be reasonable for customers over whom the former employee had a large degree of influence).

In assessing whether the duration of a restrictive covenant is reasonable in a particular case, the Courts look at the time necessary for the employer to confirm its business connections with its existing customers before facing competition from its former employee.

In *Apex Fire Protection Ltd/Murtagh*<sup>6</sup> the Competition Authority (rather than the Courts) held that a two year restriction on soliciting former customers was unreasonable. The service in question was normally required by customers once a year. Therefore, a one year period of protection would have provided the company with ample opportunity to confirm its business connections with its existing customers.

(b) Geographical Location

The restrictive covenant should be confined to the geographical market where the employer operates. Anything more than this would be considered excessive. The geographical limits of the covenant will very much depend on the nature of the work in question and the structure of the business.

In *John Orr Ltd and Vescom B.V. v. John Orr*<sup>7</sup> the High Court held that a blanket world wide restraint was excessive and said that it should be confined to the countries in which the employer had customers, although if there were definite

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<sup>6</sup> CA/1130/92

<sup>7</sup> [1987] ILRM 702

proposals for expanding into new markets this might warrant including these markets in the restriction.

However, a world wide covenants may be upheld in cases where the employer is a global entity. In the U.K. case of *LTE Scientific Limited v. David Thomas and Barbara Thomas*<sup>8</sup> the court noted that LTE was an international company and accepted that it was necessary to protect confidential information being disclosed in connection with all of the restricted activities worldwide.

Conversely, in *Mulligan v. Carr*<sup>9</sup> the Supreme Court refused to enforce a restraint of trade clause preventing a solicitor from practicing within a twenty mile radius of a small provincial town.

(c) Scope of activities

A non-compete covenant should only prevent an employee from working in the same capacity and/or in the same business as the employer.

In *John Orr Ltd and Vescom B.V. v. John Orr*<sup>10</sup> the employer manufactured and sold upholstery and garment fabrics. The High Court held that the clause in question was excessive because it prevented the employee from manufacturing or trading in wall coverings, which were the goods manufactured by its parent company. The employer itself did not trade in wall coverings.

in *Murgitroyd & Company limited v. Purdy*<sup>11</sup> the High Court held that while a 12 month non-compete restriction in the Irish market was reasonable, the restrictive covenant was unenforceable as the prohibition on dealing with potential, as opposed to actual, customers of the plaintiff company was too wide.

Non-solicitation clauses only prevent an employee from soliciting customers or employees of the employer for the purpose of competing with the employer's business. In addition, they should be limited so as to prohibit solicitation of employees or customers of the former employer over

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<sup>8</sup> [2005] EWHC 7

<sup>9</sup> [1925] 1 I.R. 169

<sup>10</sup> [1987] ILRM 702

<sup>11</sup> Unreported, Clarke J., 1 June 2005

whom the employee would have had direct control or influence in the course of his or her employment.

## **B. The Severance Rule**

If a restrictive covenant is adjudged by an Irish court to be excessive, the court may, in appropriate cases, sever the unenforceable part of the clause. What is known as a “blue pencil” test may sometimes be applied to sever the unreasonably wide element of the clause. The court will only do this where the clause is capable of standing alone without the offending provision. The court will not amend or modify the clause so as to make it enforceable.

## **C. Remedies**

Where an employee breaches a *restrictive* covenant the employer may seek an Injunction, damages or an account of profits.

The right to an injunction is predicated on the employer demonstrating that it has a prima facie case, that the balance of convenience favors granting the injunction and that damages will not be an adequate remedy. In *European Paint Importers v O’Callaghan*<sup>12</sup> an interlocutory injunction was granted restraining a former employee from doing business with any person, firm or company who had been a customer of the plaintiff in the previous year.

Damages might also be available where the employer can show loss of profit resulting from the prohibited conduct. It may however, be difficult to identify any direct financial loss.

In such circumstances, it may be more appropriate to seek an account of profits made by the employee as a result of engaging in the prohibited conduct.

However, an employer who repudiates a contract or is involved in a fundamental breach of a contract will generally not be able to rely on restrictive covenants in that contract. Such breaches could include matters such as a failure to pay salaries or payments due to employees under their contract of employment, dismissal without notice and constructive dismissal.

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<sup>12</sup> Unreported, Peart, J., 10 August 2005

### **III. COMPETITION ACT 2002**

Restrictive covenants are not expressly dealt with in the Competition Act 2002 nor in the Competition Acts 1991-1996 (which were repealed by the Competition Act 2002).

However, under the Competition Acts 1991-1996, the Competition Authority issued a non- legally binding Notice on Employment Agreements, In this Notice the Competition Authority set out its view that section 4(1) of the Competition Act 1991 which provides that all agreements between undertakings, decisions by associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition or trade in any goods or services in the State or in any part of the State are prohibited and void, applied in circumstances where an employer attempted to enforce a covenant against a former employee who had begun to trade on his own account. The Authority's reasoning was that the ex-employee then constitutes an "undertaking" for the purposes of the Act.

On 2 January 2007 the Competition Authority clarified its position through a news release by revoking its 1992 Notice on Employment Agreements. A statement in the 1992 Notice that a contract of employment may become an agreement between undertakings in certain circumstances was deemed erroneous by the Competition Authority. The consensus now appears to be that even if the employee sets up business on his or her own behalf the contract restriction does not infringe section 4 (1) of the Competition Act, 2002 (previously section 4(1) of the Competition Act, 1991).

## ITALY

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## ITALY

### **I. SUMMARY OF THE LAW**

According to Section 41 of the Italian Constitution, entrepreneurial activity is to be carried out within a free market. Consequently competition among businesses under Italian law cannot, in principle, be limited. Considering that such general principle is aimed at creating beneficial conditions for consumers (namely, lower prices) and that entrepreneurs would willingly enter into agreements in order to limit the “damage” which can originate from the business competition, legislation has been enacted to set forth the limits within which such agreements are valid.

The above mentioned legislation has two aims:

- A.** guaranteeing, as far as possible, free competition and, therefore, defining the antitrust regulations (Article 85 and following of the “EU Treaty” and Law 10 October 1990, no. 287);
- B.** setting forth limits to covenants not to compete in general (Article 2596 of the Italian Civil Code, hereinafter “Code”) or in specific relationships (Article 2557 of the Code with respect to sale of businesses or lines of businesses, Article 2125 of the Code with respect to employment and Article 1751-*Ms* with respect to agencies).

### **II. LIMITS TO COVENANTS NOT TO COMPETE — PARAMETERS OF THE REASONABLENESS TEST**

In general, Article 2596 of the Code requires that any covenant not to compete must be made in a written form and is enforceable if it is limited to a geographical area or a business activity (paragraph 1). Moreover, the term of the non-competition obligation must not exceed five years. Agreements for a longer period are automatically limited to five years (paragraph 2).

Article 2557 of the Code states that, in case of a transfer of a business or a line of business, the transferor may not initiate a new business within a term of five years after completion of the deal, that “for its object, location or other circumstances” would be fit to divert customers from the transferee (essentially, the clause protects the goodwill of the transferred business). The obligation may be derogated or broadened by the parties, with the sole limit that it cannot prohibit any professional activity of the transferor and must be limited to five years. Also in this case, agreements for a longer period are automatically limited to five years.

During the course of an employment relationship, the employee has the duty not to compete with the employer. Article 2125 of the Code provides that upon termination of the employment, a covenant not to compete may be entered into

between the employer and employee. Such agreement must be made in writing, provide a consideration in favour of the employee and limit its purpose to object, location and term. The term cannot exceed three years for employees and five years for managers (paragraph 2).

Also agents may undertake not to compete with the principal following the termination of the relationship (Article 1751 *-bis* of the Code). The agreement must

be in writing, the term must not exceed two years and it must concern the same area, customers, goods and services that were the object of the agency agreement. A consideration for the agent must also be provided for, based on parameters mentioned in the abovementioned Article.

### **III. GENERAL COMMENTS**

- The provision of Article 2596 of the Code does not exclude the possibility to renew the covenant not to compete upon expiration of the relevant term.
- The prevailing opinion is that Article 2596 applies only to “horizontal” relationships, i.e. among competitors. Limitations inserted in “vertical” relationships (e.g. manufacturers and resellers) are not within the purpose of the provision as they would concern exclusivity obligations and not non-competition undertakings (Supreme Court, decision no. 5094 of 1994).
- As a general principle, applicable to entrepreneurs, employees and agents, covenants not to compete shall not be so strict to prohibit any possible source of income (Supreme Court, decision no. 16026 of 2001, no. 7835 of 2006).
- A violation of a non-competition obligation may be ascertained independent from the existence of effective damages. The mere existence of the breach and of potential damages is sufficient to obtain a favourable judgment with consequent remedies, such as interim measures (injunction to prohibit the unlawful behaviour) and publication of the order in newspapers or magazines (Supreme Court, decision no. 1311 of 1996).
- As regard to non-competition obligations in transfers of business, it is common practice to extend non-competition obligations also to the shareholders of the transferor company (and sometimes to their family members) and to its employees (in case of transfer of a line of business) to avoid indirect competition. In addition, to strengthen the enforceability of such undertakings, it is also common practice to set forth penalties determining the amount of damages that any breach could cause.
- According to the latest case law, the provisions of Article 2557 of the Code are applicable also in case of transfers of shares (Supreme Court, decision no. 9682 of 2000). In such case it was also stated that the undertaking of a

covenant not to compete by the seller of the shares cannot include working as an employee of a competitor (Supreme Court, decision no.16026 of 2001).

- According to Section 41 of the Italian Constitution, entrepreneurial activity is to be carried on within a free market. Consequently competition among businesses under Italian law cannot in principle be limited. Considering that such general principle is aimed at creating beneficial conditions for consumers (namely, lower prices), and that entrepreneurs would willingly enter into agreements in order to limit the “damage” which can originate from the business competition, legislation has been enacted to set forth the limits within which such agreements are valid.

The above mentioned legislation has two aims:

- (a) guaranteeing, as much as possible, free competition, and therefore defining the antitrust regulations (Article 85 and following. of the “EU Treaty” and Law 10 October 1990, no. 287);
- (b) setting forth limits to covenants not to compete in general (Article 2596 of the Italian Civil Code, hereinafter “Code”) or in specific relationships (Article 2557 of the Code with respect to sale of businesses or lines of businesses, Article 2125 of the Code with respect to employment and Article 1751-*bis* with respect to agencies).

#### **IV. LIMITS TO COVENANTS NOT TO COMPETE – PARAMETERS OF THE REASONABLENESS TEST**

In general, Article 2596 of the Code requires that any covenant not to compete must be in written form and is enforceable if it is limited to a geographical area or a business activity (paragraph 1). Moreover, the term of the non-compete obligation must not exceed five years. Agreements for a longer period are automatically limited to five years (paragraph 2).

Article 2557 of the Code states that, in case of a transfer of a business or a line of business, the transferor may not initiate a new business, for five years after completion of the deal, that “for its object, location or other circumstances” would be fit to divert customers from the transferee (essentially, the clause protects the goodwill of the transferred business). The obligation may be derogated or broadened by the parties, with the sole limit that it cannot prohibit any professional activity of the transferor and must be limited to five years. Also in this case, agreements for a longer period are automatically limited to five years.

In the course of an employment relationship, the employee has the duty to not compete with the employer. Article 2125 of the Code provides that at the end of the employment, a covenant not to compete may be entered into by employer and employee. Such agreement must be in writing, provide a consideration in favour of the employee and limit its scope as to object, location and term. The

term cannot exceed three years for employees and five years for managers (paragraph 2).

Also agents may undertake not to compete with the principal following the termination of the relationship (Article 1751-*bis* of the Code). The agreement must be in writing, the term must not exceed two years and it must concern the same area, customers, goods and services object of the agency agreement. A consideration for the agent must also be provided for, based on parameters mentioned in the above-indicated Article.

#### **A. General Comments**

- The provision of Article 2596 of the Code does not exclude the possibility to renew the covenant not to compete at the expiration of the relevant term..
- The prevailing opinion is that Article 2596 applies only to “horizontal” relationships, i.e. among competitors. Limitations inserted in “vertical” relationships (e.g. manufacturers and resellers) are not within the scope of the provision as they would concern exclusivity obligations and not non-compete undertakings (Supreme Court, decision no. 5094 of 1994).
- A violation of a non-compete obligation may be ascertained independent from the existence of effective damages, the mere existence of the violation and of potential damages is sufficient to obtain a favourable judgment.
- As regards non-compete obligations in transfers of business, it is common practice to extend non-compete obligations also to the shareholders of the transferor company (and sometimes their family members) and to its employees (in case of transfer of a line of business) to avoid indirect competition. In addition, to strengthen the enforceability of such undertakings, it is also common practice to set forth penalties predetermining the amount of damages that any violation could cause.
- According to the latest case law, the provisions of Article 2557 of the Code are applicable also in case of transfers of shares (Supreme Court, decision no. 9682 of 2000).

### **THE NETHERLANDS**

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## THE NETHERLANDS

### I. STATUTORY BASE

Articles 7:653 and 7:443 of the Dutch Civil Code (DCC) address non-competition covenants in the context of employment and agency agreements, respectively.

#### A. Employment/non-compete agreements

1. According to article 7:653 DCC an employee can be restricted by his employer in his activities after the termination of his employment agreement. Causes which limit the activities of an employee during the employment are not within the scope of this article. Article 7:653 DCC requires that a non-competition covenant is in writing; normally a non-competition covenant is therefore incorporated in a written and signed employment agreement.
2. According to article 7:653 DCC the employee can be restricted in accepting employment with competitors of the employer or in performing certain activities which are similar to or in competition with the activities of the employer.
3. An employee may request the cantonal judge to annul or limit the scope of the non-competition covenant if in proportion to the interests that the employer has by enforcing the non-competition covenant, the employee's position is unreasonably affected.
4. Circumstances which may support enforcement of the non-competition covenant:
  - (a) The fact that the employee knows a lot about the business secrets, like price policy, clients, production, etc., in which cases the competitor of the employer would take unjustified advantage from this information by hiring the employee (Ktr. Amsterdam, 11 May 1995, JAR 1995/119, Rb. Amsterdam, 16 August 1995, JAR 1995/208, Ktg. Amsterdam 3 August 2001, JAR 2001/202).
  - (b) The fact that the employee may or will attract clients of his previous employer in favor of his new employer or in favor of the employee himself (Rb. Leeuwarden, sector kanton, 27 June 2002, JAR 2002/181, Ktg Lelystad, 4 October 2000, JAR 2000/256).
  - (c) The fact that the employer has put great efforts (time and money) in the employee's training, and it would be unfair for the competitor to benefit from these efforts (Arr.Rb. Zwolle,

21 May 1980, NJ 1981, 282, Pres.Rb. Arnhem 2 October 1992, JAR 1993/135).

- (d) The fact that the employment agreement was terminated at the request of the employee, or the employee's behaviour gave rise to termination by the employer (Ktg Tilburg, 17 July 2000, JAR 2000/186, Ktr. Enschede 8 October 1992, JAR 1992/107).
5. Circumstances which may give rise to limitation or annulment of the non-competition covenant:
- (a) The fact that the employee is only qualified and able to perform the activities which are forbidden and therefore will not be able to find a job when he is not allowed to use these special skills and experience (HR 25 October 2002, JAR 2002/277, Pres.Rb. Roermond, 24 December 1991, KG 1992/54).
  - (b) The fact that the job which has been offered to the employee means a significant increase of salary or a significant promotion whereas such increase of salary or such promotion is not possible in the service of the old employer (Ktg. Utrecht 28 February 1996, JAR 1996/86, Rb. Amsterdam 29 September 1993, JAR 1993/230).
6. It is advisable to limit the effects of the covenant to a limited geographical area (for example '20 kilometres around Amsterdam' or 'in the Netherlands') and to a limited number of years (normally two years). By doing so, the possibility that the judge will limit the scope or annul the non-competition covenant is minimized. The non-competition covenant can contain a penalty for non-compliance. .
7. In accordance with article 7:653, paragraph 4 DCC in some cases the judge decided that the employer, although he was allowed to enforce the non-competition covenant, by doing so he is bound to pay the employee compensation for the fact that due to the non-competition covenant, the employee is not able to find a suitable job.
8. If an employee, who is bound to a non-competition covenant, is offered a new job by his employer which substantially differs from his old job, as a result of which the non-competition covenant becomes of more weight, then it is advisable to enter into a new non-competition covenant, since the older one may be held invalid.

9. In the event of a transfer of business, the employees who were employed in the business transfer to the purchaser of the business by matter of law (art. 7:662 etc. DCC); all rights and obligations regarding these employees will therefore transfer over to the new employer, including the rights and obligations which are part of the non-competition covenants. This will not be the case if as a result of the transfer of business, the non-competition covenant would become of substantially more weight.

## **B. Agency agreements**

1. According to article 7:443 DCC a non-competition covenant with the agent is valid only if:
  - (a) it is entered into in writing;
  - (b) it relates to the type of products or services, for which the agent was hired and;
  - (c) it is limited to the area, or to the customers and the area, which were entrusted to the agent.

A non-competition covenant in agency agreements is valid only for a maximum period of two years after the termination of the agency agreement.

2. The principal cannot enforce the non-competition covenant with the agent if the agency agreement is terminated:
  - (a) by the principal without approval of the agent or without taking into account the statutory or agreed notice period;
  - (b) by the agent for reasons due to the principal;
  - (c) by a judicial decision, based on circumstances due to the principal.
3. At the request of the agent, the judge may limit or annul a non-competition covenant in an agency agreement if in proportion to the interests the principal has by enforcing the non-competition covenant, the agent's position is unreasonably affected.

## **II. SALE OF BUSINESS**

- A.** Dutch civil law does not contain any specific provisions which relate to non-competition covenants in agreements whereby a business is sold or transferred. Reference is made to the section dealing with non-competition covenants in the European Community.

## SPAIN

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## **SPAIN**

### **I. SUMMARY OF THE LAW**

Spanish legal regulation governing covenants not to compete distinguishes between those covenants while the employment relationship is in force, and those referring to a post-contractual obligation.

The non-competition obligation of the employee during the period in which the employment relationship is in force is compulsory.

In the case of Top executive employees, this obligation does not only refer to a competitor company, but to any contract, that is, Top Executive employees cannot enter into any other employment contract with third Companies, unless otherwise agreed with their prior employer (vid. art. 8.1 RD 1382/1985).

Concerning the post-contractual non-competition agreement, Spanish law establishes some requirements which must be fulfilled for the covenant to be enforceable. Among these covenants, the law establishes mainly limits of duration, the fact that the Company must have an effective industrial or commercial interest in the non-competition obligation and that an adequate compensation for this non-competition covenant is paid to the employee.

### **II. PARAMETERS OF THE "REASONABLENESS" TEST**

#### **A. Ancillary to an employment contract**

1. The enforceability of the post-contractual non competition agreement is subject to the Company having an industrial or commercial interest in maintaining it (art. 21.2.a) of the Workers' Statute for ordinary employees and art. 8.3.a) R.D. 1382/1985, for Top Executive employees).
2. The post-contractual non competition agreement also requires the payment of an "adequate compensation" (art. 21.2. b) of the Workers' Statute and art. 8.3.b) R.D. 1382/1985, for Top Executive employees). Spanish employment law does not give any indication as to when a compensation is reasonable, or adequate, but an amount around 50% of the annual fixed salary of the employee should be in general circumstances considered as "adequate" for these purposes. On the other hand, Spanish Law does not establish the moment in which this compensation must be paid and theoretically it can be paid during the life of the contract or after its termination, and can be paid as a lump sum, or in monthly installments. We suggest that the payment of this compensation is made after the termination of the contract, that

is, during the period in which the covenant not to compete is in force.

3. The maximum duration of the non-competition clause is fixed by law at 2 years for Top Executives (ex art. 8.3 R.D. 1382/1985) and technicians and six months for other employees (ex art. 21.2 Workers' Statute). The recommended extension depends on the interests of the Company and in any event, on the agreement reached by the Company and the employee.
4. In the case of Top Executive employees, certain High Courts have declared the possibility of the Company reserving the right of deciding whether to enforce the post-contractual non competition clause or not. However, this point has now been clarified by the Supreme Court, who has stated that the Company can not unilaterally waive the non-competition agreement. The covenant not to compete, once it has been agreed by both parties, can only be waived by mutual agreement between them.
5. The infringement of the obligation not to compete while the employment contract is in force would entitle the Company to terminate the employment relationship under a disciplinary dismissal procedure, that is, without being obliged to pay a dismissal compensation, provided that the dismissal is declared fair by the competent Courts. It would also be possible to claim damages from the employee (in any case, the damages compensation should be solidly proven).

## **B. Incidental to the sale of business**

1. Under Spanish Law when a Company or a business is sold, the employees of said Company or those rendering services in the scope of said business are transferred from one Company to another, keeping their specific rights and obligations (art. 44 Workers' Statute). As a result of this, the covenant not to compete will be valid, as agreed with the previous employer and provided that the abovementioned conditions are met.
2. In the case of a Top Executive employee, the change of owner or control of the Company would allow the employee to terminate the employment contract with the compensations agreed (or those established for the termination in case of waiving of the contract by the Company). However, even in the case of termination by the employee, the covenant not to compete will remain enforceable.

### **III. GENERAL COMMENTS**

It is important to highlight that covenants not to compete after the termination of the employment contract would not prevent the employee from rendering his services for a competitor, and the Employment Court will not enjoin the employee to leave the competing Company on the grounds of a covenant not to compete. In this sense, the covenant not to compete will only entitle the Company to claim damages against the employee in order to obtain compensation for the non-fulfillment of the covenant. This action is without prejudice to the possible civil actions that the Company could have against the competing company in case of unfair competition, if applicable.

On the other hand, the terms of the non competition, and what should be understood as competition can be agreed by the parties and established in the agreement signed to that effect. In this sense, the non-competition clause agreed between the parties would be valid even when the termination of employment is not justified, unless otherwise established in the contract. Therefore, if nothing specific has been foreseen in the contract in this respect, the non-competition clause would apply whatever the reason for termination may be (fair dismissal, unfair dismissal, voluntary resignation, retirement...). If the parties want to exclude from the scope of the non-competition clause any of these termination causes, they should be clearly specified in the contract.

Finally, covenants not to compete must be distinguished from exclusivity agreements. By means of the first one the employee is obliged to not render services for any competing company. By means of the second agreement, the employee commits himself not to render services for a third company while the employment contract is in force, irrespective of its economic scope.

## SWITZERLAND

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## SWITZERLAND

### I. STATUTORY BASE

Covenants not to compete are included in many contractual relationships **during their existence**. Such covenants derive from the general duty of loyalty in many long-term agreements such as employment contracts (Section 321a Swiss Code of Obligations, "CO"), agency (Section 418d CO), partnership ("Einfache Gesellschaft", Section 536 CO), partnership ("Kollektivgesellschaft", Section 561 CO) and Limited Liability Company (Section 818 CO). Noncompetition agreements can also frequently be found in pooling agreements among shareholders and license agreements.

Covenants not to compete with **effect after termination of such an agreement** are only specifically regulated in the employment context. Sections 340 et seq. CO provide for the typical covenant not to compete after termination of the employment agreement. The pertinent Section 340(1) CO reads as follows:

An employee may bind himself to the employer to refrain from engaging in any competitive activity after termination of the employment relationship, in particular neither to operate a business for his own account which competes with the employer's business, nor to work for nor participate in such a business.

Generally speaking, a competitive activity is given if two suppliers offer goods or services of the same kind, satisfy the same needs and target the same buyers (*Streiff/von Kaenel, Arbeitsvertrag, 1992, N 7 ad Section 340 CO*).

### II. PARAMETERS OF THE "REASONABLENESS" TEST

#### A. Ancillary to an Employment Contract:

A covenant not to compete is valid only if

1. the employee has full legal capacity (Section 340(1) CO);
2. the covenant is in writing (Section 340(1) CO): A covenant in standard business terms is not considered to be sufficient at least as long as there is no explicit reference in the employment contract (*Streiff/von Kaenel, op. cit., N 5 ad Section 340 CO*);
3. the employment relationship gives the employee access to customers or to manufacturing or business secrets (Section 340(2) CO);
4. the use of such knowledge could significantly harm the employer (Section 340(2) CO);
5. the covenant is reasonably limited in terms of place, time and subject in order to preclude an unreasonable impairment of the employee's economic prospects (Section 340a(1) CO);

6. the covenant does not exceed three years unless there are special circumstances (Section 340a(1) CO). Special circumstances are, however, very rarely given.

The employer loses the benefit of a covenant not to compete if he terminates the employment relationship without a valid reason or if the employee terminates the employment relationship for a valid reason for which the employer is responsible (art. 340c Para 2 CO). The covenant also lapses if the employer no longer has a significant interest in its maintenance (art. 340c Para 1 CO).

## **B. Incidental to the Sale of a Business:**

Swiss civil law does not specifically regulate covenants not to compete in agreements related to the sale or transfer of a business. The Swiss Federal Supreme Court denied in its criticized decision *BGE (=Federal Reporter) 124 III 495 ff.* the applicability of the Swiss Cartel Act on noncompetition agreements incidental to the sale of a business. The Supreme Court only applied the general personality right protection rule of Section 27(2) Civil Code ("CC") to such noncompetition agreements. The critics of this decision point out that the applicability of Section 27(2) CC does not provide specific guidelines as to the permissible duration of noncompetition agreements, and that this decision runs afoul of the very basic notion of what constitutes an agreement under contemporary antitrust law. Therefore, some authors have proposed to apply the rules set forth by the European commission with respect to the application of the competition laws to covenants not to compete (cf. *Etter, Noncompetition Agreements in connection with acquisitions of enterprises and competition law, sic! 2001, 488*).

The Swiss Competition Commission follows the predominant doctrine in this field and now holds that even a unilateral covenant not to compete principally constitutes an agreement in restraint of competition. If concluded within the framework of the sale of a business, however, the Commission does *not* qualify such a covenant as an agreement in restraint of competition provided the covenant is truly ancillary to the sale of the business. This is the case if the covenant is *directly related* to the sale of business and if it is *necessary* (that is, indispensable) in regard to its factual and geographical scope as well as its duration to make possible that the goals of the transactions can be realized. This must be assessed on a case by case basis; see, e.g., RPW ("Law and Politics of Competition", the Swiss Competition Commission official reporter) 2006/4 p. 687-690, in particular p. 689-690). To the extent that the covenant meets these criteria and is thus ancillary to the sale of the specific business, it is assessed under merger law only, and not antitrust law.

It can be concluded that the Swiss Commission follows the respective practice of the European Commission set forth in its "Notice on restrictions directly related and necessary to concentrations (OJ C56 of March 5, 2005, p. 24) by analogy.

### III. GENERAL COMMENTS

#### A. Noncompetition Agreements Ancillary to an Employment Contract:

With respect to their enforceability, it should be noted that noncompetition agreements will generally be enforced if they meet the requirements set forth in the pertinent statutory provisions (Sections 340 et seq. CO). However, an overbroad noncompetition provision not meeting the standard set forth in Sections 340 et seq. CO will be modified by the judge to a reasonably restrictive covenant; thus, it will not be invalidated. That means that covenants not to compete are not fully effective if they are not drafted carefully enough. It can be said that the courts tend to be rather critical towards the enforceability of noncompetition agreements in the employment context.

If the noncompetition agreement is combined with a penalty to ensure compliance by the employee, he can free himself from the covenant by paying the penalty (Sections 340b(1) and (2) CO). However, if specifically agreed in writing, the employer may, in addition to the penalty for breach and the compensation for further damage, request the elimination of this situation contrary to the contract, insofar as this is justified by the violated or threatened interests of the employer and by the behavior of the employee (Section 340b(3) CO).

#### B. Other Noncompetition Agreements:

Section 27(2) CC (protection of personality) applies to covenants restricting someone in its freedom in general. Hence, this provision applies not only to covenants not to compete incidental to the sale of a business but also to other noncompetition agreements. For instance, the Swiss Federal Supreme Court examined in a recent decision a noncompetition covenant in a pooling agreement among shareholders with respect to its compliance with Section 27(2) CC (*BGer, 4C.5/2003*). Furthermore, if, for instance, there is a similar close relationship between the parties involved as in an employment relationship, the courts might also apply the rules for covenants not to compete in an employment context (Sections 340 et seq. CO) by analogy to other noncompetition agreements (cf. *Chappuis, noncompetition covenants in pooling agreements among shareholders, SJ 2003 II 317; BGer, 4C.5/2003*).

**UNITED KINGDOM**

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## UNITED KINGDOM

### I. SUMMARY OF THE LAW

The starting point for non-compete covenants between an employer and an employee is that they are void, being contrary to public policy. However, such a covenant may be upheld if the employer can show:

- He has legitimate business interests which merit protection by a restrictive covenant; and
- The restriction extends no further than is reasonably necessary to protect the legitimate business interests.

(*Masons v Provident Clothing & Supply Co Ltd* [1913]; *Herbert Morris Ltd v Saxelby* [1916]; *Stenhouse Australia Ltd v Phillips* [1974]; *TFS Derivatives Ltd v Morgan* [2005]).

The ex-employer cannot protect himself against competition per se (as this is not a 'legitimate business interest') but only against unfair exploitation of his trade secrets or trade connections (*Herbert Morris Ltd v Saxelby*; *Stenhouse v Phillips* (see above)). The reasonableness of the covenant will be judged at the date the contract is made, i.e. it has to be reasonable at its inception (*Rex Stewart Jeffries Parker Ginsburg Ltd v Parker* [1988]).

A restraint must not be contrary to the public interest. However, a covenant which is reasonably necessary to protect a legitimate interest of the employer will not generally be found to be against the public interest.

The courts are more likely to strike down non-compete covenants in employment contracts than in business sale contracts due to the greater likelihood of equality of bargaining power in the latter (*Herbert Morris Ltd v Saxelby* (see above)), although non-compete covenants in business sale agreements may be subject to EC and UK competition law.

In addition to non-compete restrictions, employers should also give consideration to other types of protection available, including non-solicitation, non-dealing and non-poaching restrictive covenants, so as to ensure they have the right provisions (or combination of provisions) in place to protect their legitimate interests.

Non-compete and other restrictive covenants need to be carefully drafted and incorporated into contractual documentation. Where possible, restrictive covenants should be tailored to particular employees, or types of employees, and should be reviewed regularly to ensure they are up to date.

## II. LEGITIMATE INTERESTS

An employer's legitimate interest must be of a proprietary nature. Therefore, some advantage or asset inherent in the business which can properly be regarded as property should be identified. This is the case whether or not the employee contributed to the interest's creation (*Stenhouse v Phillips*).

In general terms, an employer may seek to protect through the medium of a non-compete covenant:

- his trade secrets/confidential information; and/or
- more rarely, his trade connections/goodwill

### A. Trade secrets/confidential information

Trade secrets and confidential information may be protected by a simple non-disclosure covenant. However, in some cases a non-complete clause may be justified (*Littlewoods Organisation Ltd v Harris* [1977])

It is important to consider what information can be properly protected. The key question is whether the trade secret can be regarded as the employer's property or whether it is itself the employee's skill, experience, know-how and general knowledge (which can be regarded as property of the employee) (*FSS Travel and Leisure Systems Ltd v Johnson and another* [1989]). Considerations such as the nature of the employment, the character of the information, the restrictions imposed on its dissemination, the extent of its use in the public domain and the damage likely to be caused by its use and disclosure to those in competition with the employer will be relevant.

In *Lansing Linde Ltd v Kerr* [1991], a trade secret was defined to cover information that if disclosed to a competitor would be liable to cause real or significant damage to the owner of the secret.

### B. Trade connections/goodwill

Non-compete clauses are used infrequently for the protection of trade connections. This is because a non-compete clause to protect trade connections is likely to run the risk of being held to go further than is necessary to protect a legitimate business interest (see below), on the basis that trade connections can normally be adequately protected by non-solicitation, non-dealing and/or non-poaching covenants. However, where a non-solicitation and/or non-dealing covenant would be difficult to police (perhaps because the identity of the customers or other connection is not documented or is unknown), a non-compete covenant may be justified to protect customer (or other) connections (*Turner v*

*Commonwealth & British Materials Ltd* [2000]; *TFS Derivatives Ltd v Morgan*).

An employer seeking to establish a trade connection must show:

- the existence of a connection that is special to it; and
- that the former employee is or will be in a position to take advantage of the trade connection (*Barry Allsuch & Co v Harris* [2001]).

It is important that there is a recurrence of clients and strong client relationships in order for the trade connection to be a legitimate interest.

### 1. Reasonable protection of legitimate interests

In order for a covenant to be reasonable it must “afford no more than adequate protection to the party in whose favour it is imposed” (*Herbert Morris Ltd v Saxelby* [1916]). The covenant must therefore be no wider than necessary to protect the legitimate interest.

A non-competition covenant is the most onerous type of covenant, because it prevents an individual from earning a living from his trade, and is therefore the most likely type of covenant to be struck down by the courts. It should therefore be focussed in order to limit:

- the type of business affected
- the geographical area of the restriction
- the duration of the restriction

#### (a) Type of business affected

The non-compete covenant must precisely define the type of business in which the employee is prevented from being engaged during the period of the restraint. That type of business should be focussed on the particular field of activity in which the employee was engaged whilst employed (*Attwood v Lamont* [1920]).

The covenant must also be limited to involvement with competing businesses (*Scully UK Ltd v Lee*).

(b) Duration

The duration should be no longer than necessary to protect the legitimate proprietary interests of the employer.

If the legitimate interest is the employer's trade connections this will normally be the time it would take a replacement employee to establish a relationship with customers such that the influence of the former employee will have been removed (*Barry Allsuch*).

In relation to confidential information, it should be considered how long the information which the employee may have gained will remain of use to a competitor.

The Courts will also have regard to the interplay between a non-compete covenant and notice/garden leave provisions. The duration of a non-compete covenant should normally be set-off against any period spent by the employee on garden leave during the notice period.

(c) Geographical limits

The geographical area should be no wider than necessary to protect the employer's legitimate business interests. The limitation should therefore bear some relation to the geographical extent of the employer's business. What area is necessary is a question of fact (*Skully*) and will depend on the nature of the business to be protected and the manner in which it is carried on. However, in many cases limiting the geographical area will not be of any practical use because the location from which business is transacted is of little relevance. In some cases a continental or worldwide restraint will be justifiable because of the international nature of the business (*Skully*); *Poly Lina Ltd v Finch* [1995]; *Polymasc v Charles* [1999]).

2. **General comments**

- Where there is a wrongful dismissal or the employer has otherwise breached the terms of the contract of employment containing the restrictive covenants, the employee will be freed from any covenants in restraint of trade (*General Bill Posting Company Ltd v Atkinson* [1909])
- A court will not rewrite covenants in order to make them enforceable (*Mason v Provident Clothing and Supply Ltd* [1913]). A court will only amend a restrictive covenant by

deleting certain words if necessary (the “blue pencil” test). Therefore, if a covenant is too wide or unreasonable at its inception, it will generally be unenforceable.

- Although there must be consideration for covenants, it is not necessary to make payments to support covenants. Indeed, a covenant which is too wide will not be saved by making a payment (*TSC Europe (UK) Limited v Massey* [1999]).

## GUAM

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## GUAM

### I. STATUTORY STATEMENT OF THE LAW

Pursuant to statute, and with certain limited exceptions, Guam prohibits post-employment noncompetition agreements:

Every contract, by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than is provided in the next two sections, is to that extent void.

18 Guam Code § 88105.

One statutory exception allows a noncompetition agreement incident to the sale of a business:

One who sells the good will of a business may agree with the buyer to refrain from carrying on a similar business within a specified district, city, or a part thereof, so long as the buyer, or any person deriving title to the good will from him, carries on a like business therein.

18 Guam Code § 88106.

The second exception allows a noncompetition agreement in the dissolution of a partnership:

Partners may, upon or in anticipation of a dissolution of a partnership, agree that none of them will carry on a similar business within the same city or town where the partnership business has been transacted, or within a specified part thereof.

18 Guam Code § 88107.

### II. JUDICIAL INTERPRETATION AND APPLICATION OF STATUTE

#### A. Lawful restriction incidental to the sale of a business:

*Shelton v. Guam Service Games*, 239 F.2d 902 (9th Cir. 1956) (court enforced a noncompetition provision in a contract for sale of a coin-operated machine business restricting the seller from competing with the buyer for five years where the seller sold the good will of the business. However, the court held the provision was invalid to the extent it purported to cover all of Guam and directed the trial court to define a narrower more reasonable geographic area to which the restraint could validly operate).

### III. GENERAL COMMENTS

A. **Protectable interests:** Although post-employment noncompetition agreements are generally prohibited by statute, a restriction on

competition will be enforced incident to the sale of the good will of a business or the dissolution of a partnership. 18 Guam Code §§ 88105 – 88107.

- B. Duration of the restriction:** Courts have approved a five-year noncompetition agreement incident to the sale of a business. *Shelton v. Guam Service Games*, 239 F.2d 902 (9th Cir. 1956); *Guam Service Games v. Shelton*, 126 F. Supp. 335 (D.C. Guam 1954)
- C. Geographic scope:** A noncompetition agreement purporting to cover all of Guam was held overbroad. *Shelton v. Guam Service Games*, 239 F.2d 902 (9th Cir. 1956). The statute permitting a noncompetition agreement incident to the sale of a business allows the restraint only for “a specified district, city, or a part thereof.” 18 Guam Code § 88106.
- D. Blue pencil/modification:** The courts may blue pencil, i.e., modify, the overbroad restriction and enforce a narrower restraint on competition. *Shelton v. Guam Service Games*, 239 F.2d 902 (9th Cir. 1956) (lower court instructed to craft a more narrow restraint to cover the municipality of Agana and its surrounding area; overbreadth did not render the clause unenforceable in its entirety).
- E. Source of Guam laws:** In 1933, Guam adopted the codes of California in place of the previous Spanish Civil Law. Courts construe the Guam statutes in light of California decisions. *Guam Service Games v. Shelton*, 126 F. Supp. 335 (D.C. Guam 1954).

## NORTHERN MARIANA ISLANDS

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## NORTHERN MARIANA ISLANDS

### I. JUDICIAL STATEMENT OF THE LAW

Although there is no governing statute, and no case has addressed the legality of a post-employment noncompetition agreement, a court in considering a provision prohibiting the solicitation of customers refused to issue an injunction where the plaintiff offered no proof of active solicitation. *Pacific American Title Insurance and Escrow v. Anderson*, 1999 WL 33992416 (N. Mariana Islands) 6 N.M.I. 15 (1999) (Plaintiff Pacific Title sought an injunction against former employee Anderson. Anderson had signed an employment agreement that included a provision prohibiting her from soliciting Pacific Title's customers for a period of two years after termination of employment. Post-termination, Anderson started a competing title insurance company. Pacific Title urged that the provision prohibited Anderson from accepting any business from its customers, i.e., net effect, a noncompetition agreement. Rejecting that interpretation, the court held that the provision only prohibited Anderson from actively soliciting Pacific Title's customers and that she was free to compete so long as she did not solicit. Further, Pacific Title had failed to offer any proof of solicitation.)

## JAPAN

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## JAPAN

### **I. SUMMARY OF THE LAW**

Under Japanese law, covenants not to compete are deemed to be an ancillary obligation to an employment agreement during the period of employment. No prior consent by the employee or written agreement is required.

On the other hand, for a covenant not to compete to be legally valid after termination of employment, it must be reasonable, and clearly expressed in a prior written agreement of the parties or the written employment work rules because it would restrict the freedom of choosing one's own occupation, a right of the employee guaranteed under the Constitution of Japan.

### **II. VALIDITY OF COVENANTS NOT TO COMPETE AFTER TERMINATION OF EMPLOYMENT**

#### **A. Prior written consent to a covenant not to compete**

In principle, a covenant not to compete after termination of employment must be clearly expressed in a prior written agreement of the parties or the written employment work rules of the employer.

There are a few cases in Japan that have upheld the application of covenants not to compete to employees after termination of employment in limited situations without prior written consent of the employee to the non-competition covenant.

In the *Chescom Secretarial Center* case (Tokyo District Court, January 28, 1993), the court ruled that a former employee had violated his obligations to his previous employer when the court found that he solicited existing clients of his previous employer, taking advantage of the knowledge and information of the clients acquired before the termination of employment contract.

In regards to the *Chescom* case, however, emphasis was placed on the characteristics of the act as a serious breach of faith rather than any explicit covenant not to compete. In *Chescom*, the former employee competed by offering competitive prices to his previous employer's existing clients knowing that previous employer has invested quite an amount in marketing.

#### **B. Reasonableness of a covenant**

Further, a covenant not to compete after the termination of employment must be demonstrated to be reasonable. Whether the covenant is reasonable involves a consideration of the following factors: (1) whether

restraint is necessary for the protection of a legitimate business interest of the employer, (2) the position of the employee during the term of employment, (3) the extent of the occupation, duration and geographic area to which restraint applies, and (4) the compensation given to the employee in return for restraint.

#### 1. Leading Case

In the *Foseco Japan Limited* case (Nara District Court, October 23, 1970), a leading case addressing this issue, the court held a covenant not to compete in a non-competition agreement to be legal and valid. In *Foseco*, an employee who was able to access certain technical information of a former employer became a director of a competitor of the former employer after the termination of his employment. There was a non-competition agreement between the parties prohibiting the former employee from working for any competitors during two (2) year period after the termination of his employment.

In *Foseco*, the court held that it is legal and valid to impose non-competition obligations after the termination of the employment of an employee who is able to access to an employer's proprietary (business and technical) information such as customer data, material or process for production, etc. while an employer cannot restrict an employee from using the general information or technique which the employee may have obtained if he or she had worked for another employer. Further, the court also held that the reasonableness of the duration, geographic area and occupation to which the restraint applies, and the compensation given to the employee in return for the imposition of the restraint should be carefully considered by balancing the employer's interests (protection of its proprietary information), the harm to the employee (career opportunity) and the public interest (monopoly, interest of general consumer).

#### 2. Cases Upheld the Restriction

In the *Shin Osaka Boeki* case (Osaka District Court, October 15, 1991), the court allowed a non-competition restriction to run for three years after termination of the employment. In this case, a sales manager maliciously deprived customer information from his previous employer so that the information could not be used by the previous employer after termination of his employment. Taking into account the facts of the case, the court held that the restriction was not unreasonable.

In the *Gakushu Kyoryokukai* case (Tokyo District Court, April 17,

1990), the court upheld a covenant and awarded damages where a teacher recruited colleagues and solicited pupils from his previous employer to his own private school, which he established during the three-year period in which the covenant not to compete was still in effect.

In the *Kepner Tregoe* case ("Tokyo District Court, September 29, 1994), an obligation to pay damages was enforced by accepting the validity of the noncompetition restriction. In this case, the prohibition against competition was agreed only with respect to the duration (12 months) and sphere of business activity (limit to own clients acquired during the contractual period). The court held that considering the duration and business activities to which the restriction applied, the restriction did not infringe public policy.

### 3. Case Denied the Restriction

On the other hand, in the *Tokyo Kamotsusha* case (Tokyo District Court, January 27, 1997), the court held that a non-competition restriction was invalid for infringement of public policy and good moral. In this case, an employee agreed with his employer that he would not work for any competitors of the employer or compete with the employer himself, as an individual or as a corporate entity, for three (3) years after the termination of his employment. The court held that a non-competition restriction is allowed only when reasonable grounds for such a restriction exist (only to the extent of necessary for such reasonable ground), appropriate procedures are taken and the compensation for such restriction is paid.

As described above, the Japanese courts have decided on the reasonableness and validity of the non-competition restriction based on some or all of four factors described in the last paragraph of this section and carefully looking into the specific facts for individual case.

## III. VALIDITY OF PROVISION FOR REDUCTION OR NON-PAYMENT OF A RETIREMENT ALLOWANCE

While including an explicit restriction on competition in a company's employment work rules is a direct way to restrict competition of employees after termination of employment, Japanese companies sometimes establish a provision for the reduction or non-payment of a retirement allowance in the retirement rules as an indirect way of imposing a restriction on competition. Such a provision is valid only if clearly mentioned in the termination rules. The reasonableness of the provision is measured by considering of the duration of non-competition period and the reduction rate of the retirement allowance.

The Supreme Court (August 9, 1977) held that it is reasonable to apply the provision of the work rules in which the retirement allowance is reduced in half when an employee works for a competitor after the termination of employment. "The Supreme Court stated that the above decision is upheld considering the characteristics of the retirement allowance which is not only deferred payment of salary but also premium or compensation for overall services rendered by the employee during his or her employment period.

However, some other court cases have held that unless an obvious breach of faith is found, the provision in which the retirement allowance is partially or entirely reduced should not be valid due to its severe characteristics, which may greatly interfere with the employee's career after termination. (The *Chubu Nihon Kokokusha* case (Nagoya High Court, August 31, 1990) and the *Venice* case (Tokyo District Court, September 29, 1995))

**PEOPLE'S REPUBLIC OF CHINA**

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## **PEOPLE'S REPUBLIC OF CHINA**

### **I. STATUTORY LANGUAGE OF THE LAW**

Article 23 of the People's Republic of China Employment Contract Law states:

An Employer may specify in an employment contract or a confidentiality agreement with an employee who bears an obligation of confidentiality and non-competition and specify the monthly compensation for the non-competition period after the termination or ending of the employment contract. If the employee breaches the non-competition covenant, he/she shall pay the Employer liquidated compensation as agreed.

Article 24 of the People's Republic of China Employment Contract Law states:

Persons subject to a non-competition covenant shall be limited to the employer's senior management personnel, senior technical personnel and other persons with an obligation of confidentiality. The scope, geographic coverage and duration of a non-competition covenant shall be agreed upon by the employer and the employee, and the provisions on such a restriction may not violate laws or regulations. Once an employment contract is terminated or ends, the term of the non-competition covenant mentioned in the preceding paragraph that prohibits a person from serving with a competitor that produces or deals in the same type of product or engages in the same type of business as the employer, or prohibits him/her from opening his/her own business to produce or deal in the same type of product or engage in the same type of business may not exceed two years.

### **II. CONSEQUENCES OF BREACH**

Article 90 of the People's Republic of China Employment Contract Law states:

If an employee violates this Law in terminating his/her employment contract, or breaches his/her confidentiality obligation or the non-competition covenant in his/her employment contract, and thereby causing the employer to incur a loss, he/she shall be liable for compensation.

In practice, the arbitrators or judges may award damages based on (a) the employer's actual loss or (b) the employer's loss of anticipated profits.

### **III. ENFORCEABILITY**

Under the Chinese civil law system, the principles of fairness and a person's right to work will have significant impact on shaping the final decision regarding the enforceability of a non-compete covenant. Usually, a covenant not to compete is enforceable under Chinese law only if the following conditions are met:

1. the employee has the legal capacity to enter into a contract;
2. the employee was granted access to the employer's business and trade secrets as a result of the employment relationship;
3. the covenant is reasonable in scope, duration, and geographic coverage;
4. the non-competition period does not exceed two (2) years after the termination of the employment relationship; and
5. the employee receives "adequate" compensation (in addition to his/her regular wages and other employment-related benefits) during the time period that the covenant is being enforced (see below for comments on the timing of payment).

### **IV. GENERAL COMMENTS**

The People's Republic of China Employment Contract Law, which became effective on January 1, 2008, codified the rules that were previously promulgated in an administrative notice issued on October 31, 1996 by the Ministry of Labor (In March 2008, the Ministry of Labor changed its name to the Ministry of Human Resources and Social Security). Under the old law as promulgated in the administrative notice, the maximum time period to enforce a non-competition covenant was three years. Essentially, the new law shortened the maximum time period for enforcing non-competition by one year.

This new Employment Contract Law, however, left two issues open to interpretation. The first issue is that the law does not specify who are considered to be senior management and senior technical personnel as mentioned in Article 24. However, this issue should not be an obstacle in practice. If there is any question whether a person should be considered a senior manager or senior technical person, the employer could rely on the catch-all phrase in Article 24 that would allow an employer to bind "other persons with an obligation of confidentiality" with a non-competition covenant.

The second issue is the question regarding what constitutes "adequate" compensation in order to enforce the covenant. What amount of compensation would be deemed "adequate" (which greatly increases the likelihood that the covenant is enforceable) varies from jurisdiction to jurisdiction. In some cases,

the amount may even vary within the same local jurisdiction from time to time. The best practice in navigating safely through this unsettled area of law is to contact the relevant local authority at or near the time when entering into an employment agreement that contains a non-competition covenant.

Regarding the timing of payments during the post-termination, non-competition period, the general rule under Article 23 is that monthly payments shall be made to the employee. But in practice, so long as the employer and the employee agree to other arrangements, such as bi-monthly or semi-yearly payments, the law does not prohibit such arrangements.

## **V. PRACTICE TIPS**

When contemplating the use of a covenant not to compete under Chinese law, one should follow this checklist:

- A.** Prepare a written agreement and have the employee sign the agreement;
- B.** Clearly define “competition” (or the specific competitors), geographic coverage and the scope of “competitive activities”;
- C.** If possible, specify a formula for calculating damages;
- D.** Define and separately identify the compensation for the time period during which employee’s non-compete covenant is being enforced after the termination of employment and obtain the employee’s written acknowledgement of both the receipt and adequacy of such compensation; and
- E.** With the assistance of counsel, understand and comply with any additional local employment regulations where the employee performs his/her work duties.

## HONG KONG

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## HONG KONG

### I. SUMMARY OF HONG KONG LAW

As a general rule, non-compete covenants between an employer and employee are unenforceable in Hong Kong as restraints on trade unless the covenant is reasonable taking into consideration the interests of the parties and that of the public. *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co Ltd.*, [1894] AC 535.

For a non-compete covenant to be enforceable, it must be designed to protect a legitimate interest of the employer and be no broader than adequately required to protect that interest.

### II. REASONABLENESS CONSIDERATIONS

#### A. Protection of a Legitimate Interest

Consideration of whether a non-compete covenant against a former employee is reasonable largely depends on whether the employer has any legitimate interest that requires protection. *BCS Building Materials Supply Co Ltd v. Cheung Chi Hung Michael* [1998] 2 HKC 425 citing *Stenhouse Australia Ltd v. Phillips* [1974] AC 391.

1. What is a legitimate interest?

An employer's legitimate interest capable of being protected by a non-compete covenant must be of a proprietary nature. *Stenhouse Australia Ltd v. Phillips* [1974] AC 391. Proprietary interests identified by courts in Hong Kong have included confidential information such as trade secrets and customer lists.

2. What is not a legitimate interest?

Although an employer may protect its proprietary interests through non-compete covenants under Hong Kong law, the law does not allow an employer to use restrictive covenants solely to protect itself against competition by a former employee. *Ng Mary (t/a Doggie House) v. Luk Siu Fun Michelle* [1987] 1 HKC 427. Where not protecting a proprietary interest, an employer cannot prevent an employee from using the knowledge and skill gained in the workplace.

## **B. Protection No Broader Than Required**

Where there is a legitimate business interest to be protected, the protection must be no broader than is required to adequately protect that interest. *Herbert Morris Ltd v Saxelby* [1916] AC. The reasonableness of a non-compete covenant's effect on scope, duration and geographical application will be considered. Courts have refused to enforce a non-compete covenant where one of these aspects was viewed as unreasonable. See *Natuzzi Spa v. De Coro Ltd.*, [2007] 3 HKC 74.

### **1. Scope of the restriction**

Hong Kong courts will consider the scope of application, such as restrictions on the employee's future employment, activities and employers, when determining the reasonableness of non-compete covenants. See *Susan Buchanan v. Janesville Ltd* [1981] HKLR 700.

### **2. Geographical limitations and duration of the restriction**

Geographical restraints in non-compete covenants must be reasonable with regards to the interest that the employer is protecting. *Candia Shipping (HK) Ltd v. Wong Chiu-wai & Anor*, High Court, Civil Action No. 629/86. Additionally, Hong Kong courts may give consideration to the former employees' ability to earn a living when determining the reasonableness of a restraint. See *Caudron, Kleber Emile Marceau v. Lorenz Kao* [1964] HKLR 594.

## **C. Additional Considerations**

### **1. Remuneration**

Remuneration paid to the employee by the employer during the term of a non-compete covenant may be considered by a court when it looks to determine the reasonableness of the covenant, but the existence of remuneration will not make an otherwise unreasonable covenant reasonable. See *Natuzzi Spa v. De Coro* [2007] 3 HKC 74 citing *TSC Europe (UK) v. Massey* [1999] 1 AC 688.

### **2. Acknowledgement of reasonableness**

An acknowledgement of the reasonableness of a non-compete covenant by the employer and employee may be persuasive as to the reasonableness of the covenant in the case of sophisticated parties. See *BCG Capital Mkts. (Hong Kong) Ltd. v. James Priest*, [2006] HKEC 1837] but will not make an otherwise unreasonable covenant reasonable.

## MEXICO

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## MEXICO

### **I. CONDITIONAL AUTHORITY**

Under Mexico's Constitution (Article 5), nobody can be impeded from dedicating to the profession, industry, business activity or type of work that she/he so elects. The individual is free to decide the occupation to which he/she will devote his/her time and activities as long as such activities are not considered illicit.

Under Mexican Federal Labor law, which is highly protective in favor of the employee when an employment relationship exists (contractually or otherwise) each employee shall enjoy certain minimum inalienable rights. Employers may grant employees additional rights and benefits, but any attempt to cause an employee to waive a minimum right will be deemed unenforceable as a matter of law. Thus, in the context of a labor agreement, all provisions can only deviate from the labor law principles if such deviation is more favorable to the employee and the employee's Constitutional guarantees are not violated.

### **II. SUMMARY OF LAW**

#### **A. Covenants Not To Compete In General**

General contracts law (Article 2028 of the Civil Code) regulates obligations not to perform an act (e.g., an obligation not to compete) and establishes that in the event of non-compliance of the breaching party shall pay money damages (*daños y perjuicios*) to the other party. An employer may not specifically enforce a covenant not to compete, but any breach of such covenant may give rise to an action of money damages.

Mexican courts (*Amparo directo 6764/58. Juan Bringas Zamora. 14 de octubre de 1959. 5 votos. Ponente: Mariano Ramírez Vázquez*) have recognized that when a party to a non-compete failed to comply with the principal obligation of not competing with the plaintiff in the sale of milk-related products for a certain term, the value of the principal obligation is represented by the damages caused to the plaintiff, including lost benefits and revenue or income lost due to the disloyal competition. Such value, shall serve as the base for the contractual agreed damages. The courts recognized that in some instances the obligation not to perform an act is the principal factor that motivated the parties to enter into a certain agreement.

#### **B. Economic Competition**

The Competition law defines two types of "monopolistic practices" (*prácticas monopolísticas*) - both "absolute" (*absolutas*) and "relative" (*relativas*). In addition, the law sets forth the criteria for judging the anticompetitive effect of a relative monopolistic practice. The practice is a

relative \_\_\_ practice courts \_\_\_ at (1) the “relevant market” (*mercado relevante*) and (2) “substantial power” (*poder substancial*). Absolute monopolistic practices are illegal per se and admit no examination of either purpose or market affected, whereas relative monopolistic practices are subject to economic analysis similar to the “rule of reason” applied in other jurisdictions. Covenants not to compete which are primarily designed to harm, interfere or limit competition and are deemed to constitute a monopolistic practice will generally not be enforceable.

Even though a party may enter into a contract that would impair that individual from performing an act, a covenant not to compete may be held unenforceable as a monopolistic practice.

### **C. Intellectual property**

Under the Industrial Property Law, any person who, because of its employment or other business relationship, has access to industrial secrets (Defined in the Industrial Property Law as any information of industrial application than an individual or legal entity keeps as confidential, that may be useful for obtaining or maintaining a competitive or economic advantage over third parties in the performance of economic activities.) of another may not disclose those without justified cause or consent from the owner or licensee. In addition, individuals or legal entities may be liable for damages (*daños y perjuicios*) for taking into employment or contracting for services from third parties with the purpose of obtaining industrial secrets. Therefore, it would be valid to agree as a non compete commitment, to keep all knowledge obtained while performing an activity secret. If the non-compete clause became unenforceable, there would still be an argued violation of the confidentiality protection granted under the Industrial Property Law.

### **D. Covenants incidental to a sale of a business**

In the context of a sale of a business, it is common to include in the purchase agreement or separately, a covenant not to compete. A binding non-competition clause should narrow down, as much as possible, the acts which are forbidden to the seller and should limit the restrictions to a period of five years. This time frame is arbitrary and intends to reflect a period of time which, while allowing the target company to develop, does not seem to create monopolistic conditions or an absolute restraint on the freedom of seller to engage in business.

## CANADA

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## CANADA

### I. JUDICIAL STATEMENT OF THE LAW

- A.** A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest. As in many of the cases which come before the courts, competing demands must be weighed. There is an important public interest in discouraging restraints on trade, and maintaining free and open competition unencumbered by the fetters of restrictive covenants. On the other hand, the courts have been disinclined to restrict the right to contract, particularly when that right has been exercised by knowledgeable persons of equal bargaining power. In assessing the opposing interests the word one finds repeated throughout the cases is the word "reasonable." The test of reasonableness can be applied, however, only in the peculiar circumstances of the particular case.
- B.** The distinction made in the cases between a restrictive covenant contained in an agreement for the sale of a business and one contained in a contract of employment is well-conceived and responsive to practical considerations. A person seeking to sell his business might find himself with an unsaleable commodity if denied the right to assure the purchaser that he, the vendor, would not later enter into competition. Difficulty lies in definition of the time during which, and the area within which, the non-competitive covenant is to operate, but if these are reasonable, the courts will normally give effect to the covenant.
- C.** A different situation, at least in theory, obtains in the negotiation of a contract of employment where an imbalance of bargaining power may lead to oppression and a denial of the right of the employee to exploit, following termination of employment, in the public interest and in his own interest, knowledge and skills obtained during employment. Again, a distinction is made. The general rule is that non-competition clauses will be upheld only in exceptional cases and that it is preferable to bind employees to non-solicitation covenants where by virtue of the employee's duties and responsibilities, those covenants would adequately protect the corporate interests. *Lyons v. Multari*, [2000] O.J. No. 3462 (C.A.), online: QL [*Lyons*]. Although blanket restraints on freedom to compete are generally held unenforceable, the courts have recognized and afforded reasonable protection to trade secrets, confidential information, and trade connections of the employer. *J.G. Collins Insurance Agencies Ltd. v. Elsley Estate*, [1978] 2 S.C.R. 916 at 923-924 [*Elsley*]; see also *Doerner v. Bliss and Laughlin Industries Inc.*, [1980] 2 S.C.R. 865 at 872-873 [*Doerner*].

## II. PARAMETERS OF THE REASONABLENESS TEST

### A. Ancillary to an employment contract.

1. *Cameron v. Canadian Factors Corp.*, [1971] S.C.R. 148 (agreement not to solicit clients, or operate factoring business in Canada, for five years; duration unreasonable, and geographic scope unreasonable because employer had no business interest outside province of Quebec); *Lyons, supra* (three-year/five mile non-competition agreement unreasonable; non-solicitation agreement would have adequately protected oral surgeon's proprietary interest in clients and referring dentists); *Reed Shaw Osler v. Wilson*, [1981] A.J. No. 693 (C.A.), online: QL (agreement not to compete or solicit in the "business of insurance" for five years; term "business of insurance" so vague as to be uncertain, and non-solicitation clause unreasonably broad because it prevented any type of employment with firms that solicited employer's customers); *Gordon v. Ferguson* (1961), 30 D.L.R. (2d) 420 (N.S. S.C. (A.D.)) (five-year/twenty-mile non-competition agreement unreasonable; duration and geographic area both greater than necessary to protect physician's proprietary interest in existing customers, particularly in a growing population); *Investors Syndicate Ltd. v. Versatile Investments Inc. et al.* (1983), 149 D.L.R. (3d) 46 (O.C.A.), rev'g on other grounds 126 D.L.R. (3d) 451 (H.C.J.) [*Investors Syndicate*] (non-competition agreement unlimited in time and space unreasonable);
2. *Elsley, supra* (agreement not to open insurance agency in three adjoining municipalities was reasonable because employee had personal relationship with policyholders who would naturally follow him if he set up his own business; an exceptional case where a non-solicitation clause would not suffice.) *Friesen v. McKague* (1992), 96 D.L.R. (4th) 341 (Man. C.A.) (agreement prohibiting involvement in veterinary medicine within 25 miles of rural community for three years was reasonable given employee's personal relationship with employer's customers); *Jostens Canada Ltd. v. Gendron*, [1993] O.J. No. 2791 (C.J., Gen. Div.), online: QL (one-year non-solicitation agreement was reasonable to protect customer base of school photography business); *Island Glass Limited v. O'Connor* (1980), 79 A.P.R. 377 (P.E.I. S.C.) (three-year agreement not to solicit employer's workers and customers, or open competing business within three miles, was reasonable to protect proprietary interests); *S.J. Kernaghan Adjusters Ltd. v. Kemshaw* (1978), 8 B.C.L.R. 3 (S.C.) (two-year/25-mile covenant not to carry on business as independent insurance adjuster was reasonable to protect employer's trade connections to agents requiring independent adjusters; employee could still be employed

in-house); *M.E.P. Environmental Products Ltd. v. Hi Performance Coatings Co.* (2006), 204 Man. R. (2d) 40 (Q.B.), (confidentiality agreement preventing former employees from actively soliciting the Manitoba employer's customers and suppliers in Manitoba, Saskatchewan and north-western Ontario for a period of five years was reasonable as it did not prevent competition in environmental products and services market, of which the employer had developed its market share over 25 years).

## **B. Incidental to the sale of a business**

1. *Doerner, supra* (five-year agreement prohibiting vendor from involvement in similar manufacturing anywhere in Canada or the U.S.; reasonable because purchasers had paid for goodwill, and vendors were virtual monopolists with a personal relationship to their customers); *Dale & Co. v. Land* (1987), 56 Alta. L.R. (2d) 107 (C.A.) (agreement by vendor not to act as insurance agent or broker within Alberta for five years after termination of employment; duration, area, and proscribed activities all reasonable, particularly given equal bargaining power of parties);
2. *Beton Brunswick Ltee v. Martin* (1996), 66 C.P.R. (3d) 320 (N.B. C.A.) (agreement prohibiting competition in ready-mix concrete business within 50 miles of purchaser's plants for five years was reasonable to protect purchaser's client base; vendor free to produce other types of concrete); *Burgess v. Industrial Frictions & Supply Co.*, [1987] B.C.J. No. 273 (B.C. C.A.), online: QL (agreement not to compete in provinces of B.C. and Alberta for five years was reasonable because vendor dealt closely with suppliers, customers and staff, and was familiar with lists of speciality products); *Ryder v. Lightfoot and Burns* (1965), 51 D.L.R. (2d) 83 (N.S. S.C.) (agreement not to compete in hearing aid business within province of Nova Scotia for three years was reasonable because number of potential customers was limited and purchaser would not have bought the business without the agreement).
3. *Cochrane Air Services Ltd. et al. v. Veverka* (1973), 13 C.P.R. (3d) 158 (O.S.C.) (agreement not to compete as tourist outfitter in Ontario for three years; geographic scope unreasonable because purchaser carried on business exclusively in Northern Ontario); *Huberman v. Hadath* (1973), 13 C.P.R. (2d) 253 (B.C. S.C.) (agreement not to compete anywhere in British Columbia except Vancouver Island unreasonable because purchaser only operated salons in lower mainland); *McAllister et al. v. Cardinal*, [1965] 1 O.R. 221 (H.C.J.) (agreement prohibiting competition across significant portions of Ontario and Quebec for 10 years; geographic scope unreasonable because purchaser's propane distribution

business restricted to a smaller area); *Sherwood Dash Inc. v. Woodview Products Inc.* (2005), 144 A.C.W.S. (3d), (non-competition clause where no geographic limitation was specified was unreasonable because it essentially disqualified employees from working in a field in which they have acquired skills and knowledge); *Trapeze Software Inc. v. Bryans* (2007), 154 A.C.W.S. (3d) 944 (Ont. S.C.J.), (clause preventing former employees from working anywhere in the world where employer marketed its products or services for one year was unreasonable).

### III. GENERAL COMMENTS

- A. Canadian courts will consider three factors when examining a restrictive covenant in an employment contract:
1. whether the employer has a proprietary interest entitled to protection;
  2. whether the temporal or spatial features of the clause are too broad; and
  3. whether the covenant is unenforceable as being against competition generally, and not limited to proscribing solicitations of clients of the former employee.

*Lyons, supra* at para. 23.

With respect to the second factor, the court in *Community Credit Union Ltd. v. Ast* (2007), 156 A.C.W.S. (3d) 113 (Alta. Q.B.) found that an employment contract with a ladder-type covenant providing many optional outcomes was not unreasonably broad or vague.

With respect to the third factor, the court in *Lyons* emphasized that general covenants against competition will only be upheld in exceptional cases. In *Aon Consulting Inc. v. Watson Wyatt & Co.* (2005), 141 A.C.W.S. (3d) 836 (Ont. S.C.J.), the court found no breach where employee contacted employer's clients to inform them he was terminated by employer but did not solicit them.

- B. Protectable interests: Canadian courts have extended protection to: goodwill; confidential information such as customer lists and trade secrets; existing stock of customers, suppliers and employees. In addition to cases cited above, see *American Building Maintenance Co. Ltd. v. Shandley* (1966), 58 D.L.R. (2d) 525 (B.C. C.A.); *Maguire v. Northland Drug Co.*, [1935] S.C.R. 412 [*Maguire*].

- C.** Canadian courts will sever the reasonable portions of a restrictive covenant in order to enforce them, as long as parties' legitimate intentions are respected. See *Investors Syndicate, supra*; *Dominion Art Co. v. Murphy* (1923), 54 O.L.R. 332 (C.A.); *KRG Insurance Brokers (Western) Inc. v. Shafron* (2007), 390 W.A.C. 116 (B.C.C.A.). Canadian courts will not, however, rewrite the agreement, or sever portions if doing so would emasculate the meaning of the agreement or if doing so would be tantamount to rewriting the parties' contract. *T.S. Taylor Machinery Co. Ltd. v. Biggar* (1968), 2 D.L.R. (3d) 281 (Man. C.A.); *Canadian American Financial Corporation v. King*, [1989] B.C.J. No. 701 (B.C. C.A.), online: QL; *Gautreau v. Arvelo* (2004), 137 A.C.W.S. (3d) 560 (Ont. S.C.J.). Notional severance for restrictive covenants in employment agreements is not permitted, and the "blue pencil rule" of deleting offending words from a contractual term to make it enforceable should only be used when the section being deleted is "clearly severable, trivial and not part of the main purport of the restrictive covenant." *Shafron v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6.
- D.** The old view was that continuing employment was sufficient consideration for a non-competition agreement. *Maguire, supra*; *Skeans v. Hampton*, [1914] O.J. No. 43 (S.C. (A.D.)), online: QL. More recent decisions make it clear that this is true only where the employer also expresses a clear prior intention to terminate if the agreement is not signed. *Watson v. Moore Corporation Ltd.*, [1996] B.C.J. No. 525 (C.A.), online: QL; *Kohler Canada Co. v. Porter*, [2002] O.J. No. 2418 (Sup. Ct.), online: QL.
- E.** Canadian case law is divided on the treatment of a non-competition agreement which provides for the forfeiture of benefits. One line of authority regards such agreements as restraints on trade and requires them to be reasonable. *City Dray Co. Ltd. v. Scott et al.*, [1950] 4 D.L.R. 657 (Man K.B.); *Furlong v. Burns & Co. Ltd.* (1964), 43 D.L.R. (2d) 689 (Ont. H.C.J.); *Taylor v. McQuilkin et al.* (1968), 2 D.L.R. (3d) 463 (Man. Q.B.); *Henriksen v. Tree Island Steel Co.*, [1983] B.C.J. No. 1777 (B.C. S.C.). Another line of cases states that there is no restraint on trade where only economic benefit (as opposed to legal right) is affected. *Inglis v. Great West Life Assurance Co.*, [1942] 1 D.L.R. 99 (Ont. C.A); *Webster v. Excelsior Life Insurance Co.* (1984), 50 B.C.L.R. 381 (S.C.); *Roy v. Assumption Mutual Life Insurance Co.*, [2000] N.B.J. No. 1 (N.B. Q.B.), online: QL. In *Mezaros v. Barnes* (1977), 73 D.L.R. (3d) 407 (Man. Q.B.), the court endorsed the latter analysis in *obiter*, but then applied a reasonableness test.
- F.** Where a contract contains no express choice of governing law, Canadian courts will employ the "proper law doctrine", which holds that the choice is to be inferred from all the circumstances surrounding the transaction, e.g. residence of the parties, place of contracting, place of performance, and location of subject matter. *Montreal Trust Co. et al v. Stanrock Uranium*

*Mines Ltd.* (1965), 53 D.L.R. (2d) 594 (Ont. H.C.); *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443; *Eastern Power Ltd. v. Azienda Comunale Energia & Ambiente* (1999), 178 D.L.R. (4th) 409 (Ont. C.A.).

- G.** The leading Canadian judicial definition of “trade secret” is found in *R.I. Crain Limited. v. Ashton et al.*, [1949] O.R. 303, where the court accepted the following American definitions:

1st. "A trade secret ... is a property right, and differs from a patent in that as soon as the secret is discovered, either by an examination of the product or any other honest way, the discoverer has the full right of using it. *Progress Laundry Co. v. Hamilton*, 270 S.W. 834, 835, 208 Ky. 348."

2nd. "A trade secret is a plan or process, tool mechanism or compound known only to its owner and those of his employees to whom it is necessary to confide it. *Cameron Mach. Co. v. Samuel M. Longdon Co.*, N.J. 115 A. 212, 214; *Victor Chemical Works v. Iliff*, 132 N.E. 806, 811, 299 Ill. 532."

3rd. "The term 'trade secret', as usually understood, means a secret formula or process not patented, but known only to certain individuals using it in compounding some article of trade having a commercial value, and does not denote the mere privacy with which an ordinary commercial business is carried on. *Glucol Mfg. Co. v. Shulist*, 214 N.W. 152, 153, 239 Mich. 70."

4th. "A trade secret may consist of any formula, pattern, device, or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. A trade secret is a process or device for continuous use in the operation of the business. The subject matter of a trade secret must be secret. Restatement, Torts, 757."

- H.** A good introduction to these issues is provided by K.G. Fairburn & J.A. Thorburn, *Law of Confidential Business Information*, looseleaf (Aurora, Ont.: Canada Law Book, 2007).

## ISRAEL

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## ISRAEL

- I. The laws of the State of Israel do not specifically deal with employees not competing with their former employers. However, the employer's right to restrict a former employee's dealings, despite the restriction in the Basic Law: Freedom of Occupation, may be deduced, *inter alia*, from the Commercial Torts Law, 5759-1999 and the Contracts (General Part) Law, 5733-1973.
- II. We shall first set out the employee's freedom of occupation which the employer seeks to restrict (and in fact, harm).
- III. The Basic Law: Freedom of Occupation grounds the principle of freedom of occupation and provides that every citizen or resident of Israel is entitled to deal in any business, profession or occupation and that this freedom of occupation may only be harmed by a statute that is in compliance with the values of the State of Israel (see HCJ 1683/93 *Yavin Plast Ltd. v. National Labor Court at Jerusalem*).
- IV. Under Israeli common law, the principle of freedom of occupation will find expression in the field of private law and will also impact on contractual arrangements in the field of labor relations regarding to restriction of the freedom of occupation following termination of the employer-employee relationship.
- V. The courts in Israel have held that as a rule, an order restricting the freedom of occupation of an employee will not be given without striking a balance between the employer's right to defend his property and his trade secrets, and the interest of the employee and the public in employment mobility. In balancing these interests, the employee's interest prevails for the following reasons:
  - A. The Basic Law: Freedom of Occupation grants the employee the right to work in any occupation.
  - B. Since there is a presumption of basic inequality between the employee's power and that of the employer, certain conditions which a reasonable employee would presumably not agree to of his own free will, will not be enforced.
  - C. A person's place of work is a place of satisfaction and self-accomplishment. Restricting an employee's mobility will harm his right to self-fulfillment.
  - D. Restricting an employee's right to move from one place of work to another also harms free competition.
  - E. Society has an interest in the rapid and free transfer of information in the

market.

1. However, despite the fact that the courts in Israel have recognized freedom of occupation as a supreme protected right of employees by virtue of the Basic Law: Freedom of Occupation, in each and every case, like any right, it must face other legitimate interests which seek to derogate from it, including the interests set out in employment agreements.
2. The leading case with respect to stipulations in a labor contract requiring the preservation of trade secrets and prohibiting an employee from competing against his former employer due to the legitimate interests of the employer is Dan Frommer, Check Point Software Technologies Ltd – Redguard Ltd., (*Labor Appeal 164/99*) (hereinafter: "*Check Point*"). Since publication of this decision on June 4, 1999, the Court has reiterated this rule in its later decisions, including the judgment in *AES System Inc. & Ors. v. Saar & Ors.* (Civil Appeal 6601/96). It was emphasized in that case that an employee's undertaking not to compete with his former employer following the end of his term of employment, where such does not reflect the employer's legitimate interest in prohibiting such competition, goes against the public good.
3. According to *Check Point*, in order to examine whether the restriction of competition contained in an employment contract is "reasonable", it is necessary to look at a number of criteria which, following such examination, might mean that the stipulation in the employment contract should not be enforced.
4. As a rule, a condition in a personal employment contract restricting later employment should not, in and of itself, be given too much weight. It should only be given significance if it is reasonable and in fact protects the interests of both parties, including the prior employer, and, more importantly, the prior employer's trade secrets. In the absence of the appropriate circumstances (which shall be set out below), and mainly in the absence of "trade secrets", the principle of freedom of occupation will prevail over the principle of freedom of contracting.
5. According to *Check Point*, the circumstances that permit restricting an employee's freedom of occupation are:
  - F. Trade secret – the court will restrict an employee's freedom of occupation in order to prevent him from unlawfully using a trade secret belonging to his former employer. In the high-tech industry, the intellectual property of a company is one of its most important assets and high-tech companies invest large funds in such property. The court will only award an injunction

restricting the freedom of occupation of an employee if the employee's job with his new employer threatens the very existence of the previous employer. Thus, the previous employer must prove that the use that the employee is making of his trade secret will indeed harm the business that he owns.

The Commercial Torts Law, 5759-1999 deals, inter alia, with the prohibition against theft of trade secrets. Section 5 of the Law defines a trade secret as "business information of any kind that is not in the public domain and that cannot easily be lawfully disclosed by others, the confidentiality of which affords the owner of it a business advantage over his competitors, provided that the owner has taken reasonable steps to keep it confidential."

However, it has been held that the term "trade secret" is not a "magic word". An employer claiming the existence of a "trade secret" must prove its existence, i.e., he must describe and detail what the secret is. The court interprets the term "trade secret" in light of the public good, the right to freedom of information and the question of whether exposure of the "secret" to the public will be of any significance. In *Check Point*, the court held that at times, these considerations will prevail over the protection that an employer's "trade secret" should be given.

As stated above, an employer claiming the existence of a "trade secret" must prove the existence of it. The court in Israel will not make do with a general description or a general claim as to the existence of a "secret" but rather, will ask the previous employer to indicate a sample, software, formula, or particular example, a particular client list, particular process, etc. In proving the trade secret, the previous employer must also prove the scope of the "secret", and the duration of the period in which it must remain secret. The previous employer will also be required to prove that he took reasonable steps to ensure preservation of the trade secret, such as: Disclosure of it only to those employees who need it for the purpose of their employment, and non-disclosure of it to other employees, or keeping the material in a well-protected place.

In order to restrict the employee's subsequent employment, the previous employer must prove that there is evidence or that there are circumstances that point to a reasonable possibility that the employee will use the trade secrets in his possession in the course of his work with the new employer, thus breaching his duty of trust.

There are cases where knowledge in the field of hi-tech, including knowledge of certain software, will be considered a trade secret. One of the indications of knowledge being a trade secret is that the software bears a classification of "confidential", and the number of available copies of it is restricted. Products that are being designed and developed are

considered to be trade secrets where the information in question is not in the public domain, cannot be easily reconstructed and grants the employer a commercial advantage over his competitors.

In Labor Appeal 86/08 Shachal Telemedicine v. Roni Tuval, the Court reiterated the above tests and applied them with respect to the company's customer list. The customer list was recognized by the Court as a protectable trade secret if financial resources and effort, which could be spread over a number of years, are expended in creating it. However, notwithstanding recognition of the importance that customer lists have to an employer, we should not generalize and say that wherever an employer presents a customer list, the list will be protected. This kind of list has only been recognized as a "secret" where the list requires some special effort to compile and in those cases where it is proven that there is some added value in obtaining the list ready-made. The same is true for cases where the list is of customers with whom the former employer has commercial relations, provided that they are real customers in respect of whom the company has relevant commercial information.

It should be noted that as a rule, a person's knowledge, experience and qualifications will not fall within the ambit of a trade secret. The knowledge and experience acquired by an employee during the course of his employment become part of his qualifications and he may make use of them as he wishes. Where an employee moves to a new place of work, he does not have to "erase" all of the information and experience that he accrued in his previous job. But that is so long as the employee does not otherwise make use of a trade secret belonging to his former employer.

- G.** Special training – in the event that the employer invests special and expensive resources in training the employee, as a result of which the employee undertakes to work with the employer for a particular period, the employee's employment may be restricted for a particular period in consideration for the employer's investment in such training. Clearly, if the employee acquires the training during the ordinary course of his employment or at his own expense and during his own free time, the previous employer is not entitled to limit his use of such training.
- H.** Special consideration for restriction of occupation – it is necessary to examine whether the employee received special remuneration for his undertaking not to compete in the future with his current employer, upon termination of the employer-employee relationship. Payment for a period of transition/force unemployment after termination of employment relations can be deemed to be special consideration for restriction of an employee's occupation, with respect to a 1:2 arrangement (payment of one month's salary in return for 2 months of restriction of subsequent employment).

- I. Duty of good faith and fiduciary duty – weight must be given to the good faith of the employee and/or the new employer. A relationship of trust exists between an employee and their employer. The fiduciary duty owed by an employee to his employer imposes stricter norms of conduct upon the employee than are imposed by the duty to act in good faith. An example of breach of the fiduciary duty is engagement by the employee, during the course of his employment, in contracts with other persons for the purpose of copying his employer’s production process. In this context, it should be noted that the fiduciary duties imposed on senior officers are broader than those imposed on more junior employees. Many duties can be derived from the fiduciary duty imposed upon an employee, most of which relate to the period of time during which labor relations are in existence. However, the fiduciary duty also exists at the end of labor relations and is usually related to the question of the employee competing with his previous employer.

Pursuant to *Check Point*, the National Labor Court handed down a ruling which recognized legitimate restriction by the employer on the basis of the employee’s duty of good faith (Lab. App. 189/03 Girit Ltd. – Mordechai Aviv). In that case, it was held that the non-competition restriction imposed on employees served to protect a legitimate interest of the employer and therefore the contractual restriction on occupation imposed upon the employees was upheld on the basis of the public good which seeks to prevent situations in which employees can become Trojan Horses on the employer’s premises, taking away huge chunks of information with them when they leave.

- VI. Note that the circumstances described above are not a closed list and the Court must consider each case on its merits, on the basis of all of the circumstances, the guiding rule being that restrictions on future employment will not be enforced unless one of the circumstances appearing above is in existence. Note also that the existence of one of the above circumstances is not sufficient to require the Court to enforce a stipulation restricting later employment and the ruling will be based on all of the principles and interests relevant to the matter, and on the specific circumstances of the case.
- VII. Therefore, a broad non-competition clause that aims, prima facie, to broadly protect the employer against future competition by his employee could be completely overruled by the Court, leaving the employer without protection.
- VIII. It should also be noted that confidentiality and non-solicitation clauses in employment agreements are also based on the fiduciary duty, the duty of good faith and the duty of fairness owed by the employee to the employer. Breach of these duties amounts to real harm to the public interest and the public good which will not be permitted.

- IX.** In summary, the Courts in Israel have considerably limited the ability of employers to restrict the freedom of occupation of their employees. Therefore, nowadays, employers will be hard-pressed to prevent situations in which their former employees choose to work for competing businesses, except in cases that involve trade secrets, use of customer lists and certain circumstances such as professional training at high cost provided to employees by their employers.
- X.** With respect to an employee's freedom of occupation contemporaneous with his present employment (as distinct from after termination of employment), the balance of rights changes and the ruling might be different. The weight of the consideration of freedom of the employee's occupation in terms of his basic subsistence and the initial and only source of his livelihood diminishes on the scales of the employee's rights since the employee already has a basic source of livelihood which enables him to feed his family at the end of the day, and the additional job in question is merely a supplement to the existing job. While the weight of what was a serious consideration diminishes on the scales of the employee's rights, a consideration taken from the field of freedom of occupation increases in the employer's favor, in terms of the "freedom to employ or not to employ". Since at this stage an employment relationship still exists between the parties, the employer will be entitled, in certain cases, to make the employee's continued employment with him subject to his not doing other work at the same time with a competitor or with a person who might cause damage to the employer. Therefore, the employer's interest in protecting himself (which has become part of the procedure of private work permits) is sufficient to prevent an employee from doing other work at the same time as his own work (see *Miscellaneous Civil Applications (Jerusalem) 2501/00 Shimon Parnas v. Broadcasting Authority*).
- XI.** As for the new employer's responsibility in maintaining a trade secret or in non-competition, it should be noted that in HCJ 1683/93 Yavin Plast v. National Labor Court, the Court held that a third party who knowingly and without justification enters into a contract with the employee and receives the trade secret from him commits the tort of inducing breach of contract. A third party which causes a breach of an employee's duty of confidentiality towards his former employer might be required to pay compensation (in the case of a tort such as inducing breach of contract) or restitution (in the case of unjust enrichment). Likewise, the Court may order the third party to cease inducing the breach of contract. In this context, the Court has jurisdiction to order the new employer not to employ the employee fully or partially as the case may be, to the extent that such may be necessary in order to prevent disclosure of the trade secret.

Note that the existence of the tort of inducing breach of contract is conditional upon the intervening party's causing the contracting party to breach the contract between him and another party to the contract, inter alia, by soliciting him not to perform the contract, by entering into a contradictory transaction, by preventing performance of the contract, etc.

