2012 LABOR AND EMPLOYMENT LAW SUMMIT:

Getting Up to Speed With the Latest Labor and Employment Developments

Drafting and Enforcing Noncompete Agreements; Latest Developments

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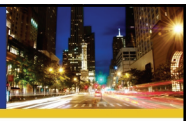
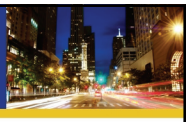
Goals



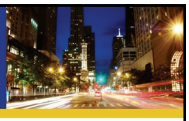
- Understanding restrictive covenants
- Grounding in enforceability
- Drafting enforceable restrictions
- New developments

What Are Restrictive Covenants?



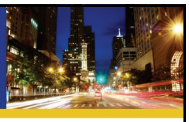
- A contract to limit activities after transaction
- A restraint of trade
  - Illegal if naked or unreasonable

A Contract



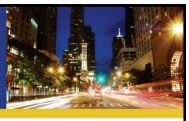
- All basic contract principles apply
  - Offer, acceptance, consideration
  - In writing if more than one year to perform
  - Not enforceable by first-to-breach
    - Wrongful discharge
    - Involuntary termination generally
  - Construction
    - Literal meaning, read in totality, give effect to all terms, don't render term meaningless

A Restraint of Trade



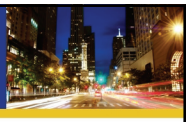
- Illegal if "naked" (e.g., contract that is nothing but a payment for a promise not to compete)
  - Must be ancillary to legitimate contract
    - Part of and subsidiary to otherwise valid transaction (or relationship?)
  - That *gives rise* to an interest worthy of protection
- Illegal if not reasonably necessary to protect that interest
  - No further than necessary
  - Reasonable to public as well as parties

Ancillary To Legitimate Contract



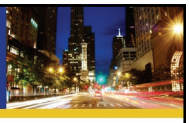
- Employment
- Agency
- Sale of Business
- Partnership
- Franchise
- Other Distribution contracts
  - Manufacturer's representative
  - Independent dealers
- Settlement?

Interests Worthy of Protection



- Trade secrets
- Other confidential information
- Goodwill
- Relationships
  - Customer (near-permanent?)
  - Employee (skilled, high-level?)
  - Vendor?
  - Referral sources?
- General promotion to market
- Training beyond general skills

Necessary to Protect That Interest

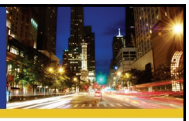


- Non-Compete
- Non-Disclosure/Confidentiality
- Non-Solicitation
- Non-Hire or No-Switch
- Anti-Raiding/Anti-Piracy
- Forfeiture for competition
- Fee for competition
- Garden Leave/Notice Provisions

Types of Covenants

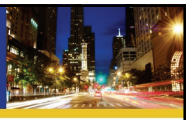
- Confidentiality restrictions
  - Only a few states treat these as restraints of trade
    - Florida, Georgia, Massachusetts, West Virginia, Wisconsin
  - May only be enforceable to protect trade secrets
  - Cannot make information confidential by decree
- Covenant not to solicit
  - Some states view these as restraints of trade
    - Alabama, Georgia, Louisiana, North Dakota, Oregon, Wisconsin
  - Others do not
    - Illinois (lower degree of scrutiny)

Types of Covenants



- Covenant not to hire ("no switch" agreements)
  - Some states treat these as restraints of trade
    - AL, MS, OR, SD, WI
  - Others do not
    - MD, MS (statute overruling appeals court), NY, VA
- Forfeiture for competition provisions
  - Some states treat these as restraints of trade
    - CA, IL, MA, PA, WI
  - Others follow "employee choice" doctrine, at least for voluntary terminations
    - MD, NY, VA

Types of Covenants



- Fee for competition
  - Payment for customers taken
  - Generally treated as a restraint of trade
- Garden Leave
  - European approach: 25-80% pay during period of non-competition
  - Have to pay even if covenant unenforceable? NY
- Notice Provisions
  - Lengthy notice required; off work but still an employee
  - Not a restraint of trade: Alabama, Georgia, Texas
  - But courts unlikely to force continued employment

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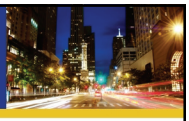
Basic Considerations

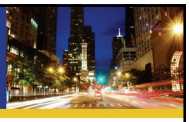


Protectible Interest/Rule of Reason Analysis

- How Courts/Juries View Non-Competes
- One Size Does Not Fit All
  - State/Jurisdiction Specific
    - **Feel free to ask questions about any state's law at any time**
  - Industry Specific (Internet business v. bricks & mortar)
  - Activity Specific (R&D v. salespersons)

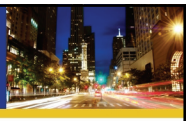
This presentation does not convey the complexity of the laws of each state/jurisdiction. You should always do a "reality check" and research the actual case law of each state/jurisdiction. Other factors can also affect the analysis.

Noncompetes: The Basics



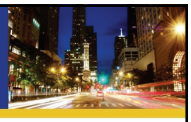
- Protectible Interest/Rule of Reason Approach
  - Is the restraint reasonably limited in terms of:
    - Time
    - Territory or market
    - Activity
  - Look at the employee's duties, location(s) and other relevant items (e.g., customer cycle). Be able to show reasonableness.
- Courts will generally go back to this element when assessing the reasonableness of a non-compete.

General Guidelines

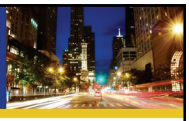


- State/Jurisdiction Differences
  - Time
    - Employment
    - Sale of Business
  - Geography
    - Employment
    - Sale of Business
  - Reformation/Blue-Pencil Doctrine

Enforceability

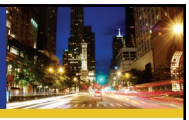


Sources of Law



- Federal Antitrust Law
  - Not much effect
  - Sherman Act § 1 – "Every contract . . . in restraint of trade . . . is declared to be illegal."
    - Requires showing of adverse effect on competition, not just a competitor
  - Sherman Act § 2 – No one "shall monopolize, or attempt . . . or conspire . . . to monopolize" interstate trade
    - Noncompete covenants "are . . . rarely condemned unless they occur within an overall context of unfair monopolistic practices."

Sources of Law



- State Law
  - Common law – all states
    - Restatement (Second) of Contracts § 188
      - ancillary to certain contracts:
      - reasonable as to:
        - » Promissee
        - » Promissor
        - » Public
  - Statutes
    - Virtually all states have restraint of trade statutes
    - 18 states have covenant-specific statutes

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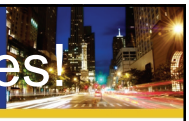
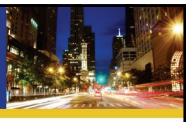
State Law Controls, And Varies!



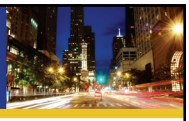
- Some states forbid restrictive covenants altogether
  - CA, ND: no non-compete or non-solicitation
- Other states limit enforceability:
  - AR, GA, MT, NE, TX, VA, WI
- Much depends on approach to partial enforcement

Partial Enforcement



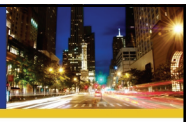
- Reasonable alteration (red pencil)
- Blue pencil
- No blue pencil

Reasonable Alteration



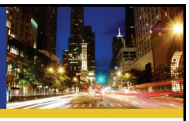
- Most states allow courts to freely modify unreasonable covenants to make them enforceable.
  - Change five years to one year
  - Change 100 miles to 50 miles
  - Change “in USA” to “in New York State”
- Court may decline to modify if too unreasonable.

Blue Pencil



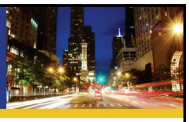
- Dozen states limit courts to “blue pencil”
  - Can only strike out unreasonable term
  - May be limited to contracts where severability evident from text
    - Strike “Ohio” from “Ohio, Indiana, Iowa”
    - Strike nondisclosure but not noncompete
  - Cannot rewrite “100” to “50”
  - “Step-down” provisions can be tailored to this power
    - “for two years (or if courts deems unreasonable, one year)”

No Blue Pencil



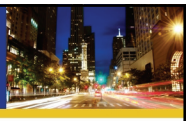
- A few states prohibit any modification
  - If covenant has unreasonable provision, it is unenforceable – even if it has a savings clause
  - "Must be valid as written"
  - AR, CA (employment), NE, VA, WI
- But may still enforce other covenants
  - VA, WI

The "Enforceability" Analysis



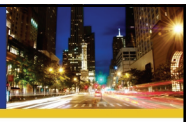
- Pertinent considerations:
  - Reasonable time period?
  - Reasonable geographic scope?
  - Reasonable restrictions on activities?
- "Case-by-case" assessment considering the unique circumstances presented in each case
  - So, generalizations about enforceability, or unenforceability, are unwise
- Who is the "good guy" or the "bad guy" in the particular case? It matters.

Confidentiality Promises



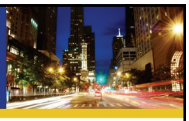
- Typically do not need time or geographic limits to be enforceable
- Contract defines what is “confidential”, but courts pragmatically apply these to protect only information that the employer kept in-house or protected
- Very enforceable; employer’s interest is high and burden on employee is low

Noncompete Provisions



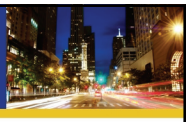
- May be enforceable, may not be; burden on employee is high, so employer must show its legitimate need for enforcement
- Time: One to two years is typical; up to three years can work sometimes.
- Geography: Best if limited to area of employee’s former job
  - Can be whole US if justified by circumstances
  - Worldwide is challenging to enforce; likely to be reduced if allowable by the applicable state

Noncompete Provisions



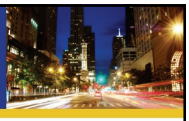
- Activities Restricted: best if limited to those performed by employee for employer, or those that would implicate confidential information of former employer
  - Prohibiting any employment with competitors typically overbroad; this is the "janitor" problem
- Especially in state with "all or nothing" enforcement, a close assessment of this often shows the noncompete to be overbroad and therefore entirely unenforceable

Nonsolicitation Of Clients



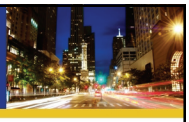
- Typically enforceable if limited to clients previously served by individual for former employer
  - Justified by investment in "good will"
- Dicey: clients individual brought to employer
  - Because employer did not invest in the good will
- Can be overbroad if covering all clients of employer
  - Because individual had no good will with those that he did not know or serve

Nonsolicitation Of Clients



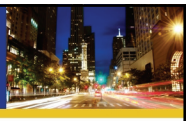
- Time Period: One to two years is typical and enforceable; but longer may be justified
- Geographic Scope: Unlike noncompetes, generally not required
- Inclusion of "prospects" or "potential clients" often makes these unenforceable
- Main point: Employer's right to protect client relationships that it permitted employee to enjoy

Nonsolicitation Of Employees



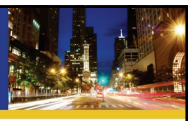
- Enforceable as to employees individual supervised or worked with
- But may be overbroad if includes all employees in the company
- Often overbroad as to former employees
- Time Period: One to two years is typical; up to three may be justified by circumstances
- Geography: Not really applicable

Nonsolicitation Of Employees

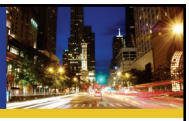


- Trend: viewing “no hire” as an unfair limitation on the employment opportunities of others.
- Nonsolicitation clause prevents actively tempting employees to leave
- No-hire clause prohibits hiring even if employee already quit and promisor did no soliciting.

Drafting Covenants

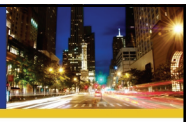


Drafting Covenants: Consideration



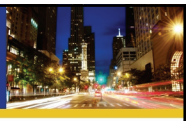
- After-thought covenants
  - Additional consideration required?
  - Employee Transfers and/or Promotions (Massachusetts Example).
  - ***Example:*** *The parties acknowledge Employee's existing employment with the Company, and, upon the effectiveness of this Agreement, the parties wish to replace all prior employment agreements between the parties, including the Employment and Non-Compete Agreement, dated as of _____, 2009, between Employee and the Company, with this Agreement, which is executed in connection with Employee's promotion and an increase in Employee's compensation.*

Drafting Covenants: Restrictions



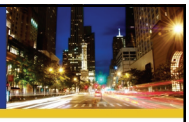
- Define business/interest to be protected
- Consider risk posed by promissee
  - What
  - Where
  - How long
- Check for consistency

Drafting Considerations



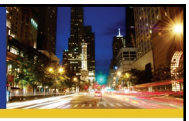
- Definition of Business
  - Is it specific?
  - Will someone be able to determine what the company does from the document?
  - Does it contain dangerous "catch-alls?"
    - "Any business in which **[the Company/Employee on the Company's behalf]** is engaged…"
- Customer-Based Restrictions
  - Prospective (Identified?) v. Actual
  - Geographic limitation required?

General Drafting Guidelines



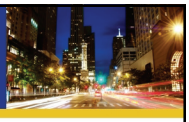
- Interplay between Geography and Business
- Examples (Assume confidentiality provisions, reformation, savings and severability clauses and right to seek an injunction provisions are included):
  - Expansive geographic scope/narrow business description.
  - Limited geographic scope/general description of business.
  - Look at the definition/description of business.

General Drafting Guidelines



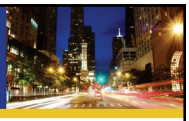
- Look at the maximum geographic scope if the locations are based on where an individual works (Connecticut).
- If an arbitration clause, is the right to seek an injunction for violation of non-compete/confidentiality included?
- No right answer – always come back to the protectible interest/rule of reason.

General Drafting Guidelines



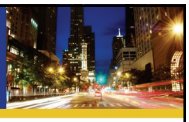
  - Virginia – "employee of…"
    - "where Employee's position and/or services involve or require the performance of duties substantially similar to those Employee performed for the Company"
    - "with a view toward offering or providing Competitive Services to such Company Customer or to the customers of such Company Referral Source"
- Stay away from gender-specific pronouns.
- Remember that one size does not fit all!

Drafting Considerations



- Effect of Employer Termination of Employee
  - Breach
  - Cause v. without cause
- Jury Trial Waivers
  - Probably a good idea if they are enforced
  - Rarely enforced
  - Be Very Careful

Drafting Considerations



- Right to an Injunction/Equitable Relief
  - Seek v. obtain.
  - ***Example**: Since a material purpose of this Agreement is to protect the Company's investment in Employee and to secure the benefits of Employee's background and general experience in the industry, the parties hereto agree and acknowledge that money damages **[may/will]** not be an adequate remedy for any breach of the provisions of this Section _ [Non-Compete Section] and that any such breach **[may/will]** cause the Company irreparable harm. Therefore, in the event of a breach by Employee of any of the provisions of this Section _ [Non-Compete Section], the Company or its successors or assigns shall be entitled to **[seek]** specific performance and/or injunctive or other relief in order to enforce or prevent any violations of the provisions of this Agreement. Such relief shall be in addition to other rights and remedies existing in the Company's favor **[and shall be granted without the posting of a bond or other security and without proof of actual damages]**.*

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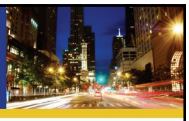
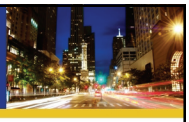


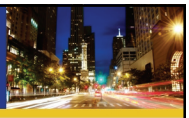
- State Law
  - Where the employee lives or works; not Delaware.
  - Public policy argument.
- Forum Selection Clauses
  - An important consideration depending on the hardship to the employee.
  - Beware of the public policy argument.
  - Example: Employee hereby agrees that any claim or action regarding or relating to this Agreement shall be subject to the exclusive jurisdiction of the state courts of the [State/Commonwealth/District] of _____ or the federal district court for the _____ District of _____ and Employee hereby submits to the exclusive jurisdiction of said courts.

Drafting Considerations



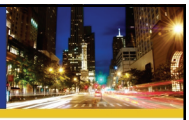
- Alternative Dispute Resolution Clauses
  - Good or bad for enforcing non-competes?
  - Current Issues regarding arbitration.
  - ***Example 1:*** *All disputes under this Agreement shall be submitted to and governed by binding arbitration with an arbitrator from the American Arbitration Association; except only that the Company may seek relief in a court of competent jurisdiction in the event of a claimed violation of Section _ [Non-Compete Section] or Section _ [Confidentiality/Inventions Section] of this Agreement.*
    - **DO NOT USE IN CALIFORNIA**

Drafting Considerations



- ***Example 2:*** *Arbitration Agreement. All disputes involving the application, interpretation or enforcement of this Agreement shall be submitted to and governed by binding arbitration with an arbitrator from the American Arbitration Association ("AAA"); except that the Company and Employee may seek relief in a court of competent jurisdiction in the event of a claimed violation or improper use of Section _ [Non-Compete Section] or Section _ [Confidentiality/Inventions Section] of this Agreement. Except with respect to any claimed violation or improper use of Section _ [Non-Compete Section] or Section _ [Confidentiality/Inventions Section], neither the Company nor Employee may invoke arbitration more than ninety (90) days after the invoking party knows, or should have known, sufficient information to give that party an understanding that the parties have reached an impasse on their respective positions regarding the application, interpretation or enforcement of any provision of this Agreement. Failure to invoke arbitration within that ninety (90) day period shall constitute a waiver of any such right If either party invokes arbitration, the Company shall pay the initial AAA file-opening charge, and fees and costs shall be awarded in conformance with the applicable AAA rules.*
- *The AAA rules can be found at www.adr.org.*

Drafting Considerations



- Not Necessarily a Perfect Solution – Check with local counsel
- Assignment
  - Stock v. asset deals
  - Example: This Agreement is intended to bind and inure to the benefit of and be enforceable by Employee and the Company, and their respective successors and assigns. Employee may not assign Employee's rights or delegate Employee's obligations hereunder without the prior written consent of the Company. The Company may assign its rights and delegate its duties hereunder without the consent of Employee to Permitted Transferees.

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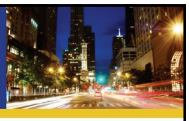
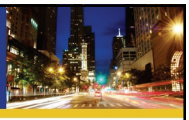


- Statement that the Agreement is reasonable and not unduly harsh or oppressive
  - Reference to other gainful employment opportunities
  - ***Example 1 (Broad Territory):***
    - *Employee agrees that the restraint imposed under this paragraph __ is reasonable and not unduly harsh or oppressive and that, in the event that Employee is subject to the Non-Compete following the Employment Period, Employee would be able to find gainful employment within the Restricted Territory in the general field of _____, without providing the highly specialized _____ services and products that Employee is prohibited from providing during the Non-Compete Period.*
      - *See long version in attached materials.*
  - ***Example 2 (Local Sales Route).***
    - *See example in attached materials*

Drafting Considerations



- Legal Effect/Attorney Review
  - Typeface, location in document. Make sure it is conspicuous.
  - ***Example:*** *<u>Employee Acknowledgement</u>. Employee acknowledges and agrees that Employee has been given ample time and fair opportunity to review this Agreement, to ask any questions Employee might have, to consult with an attorney or other professional and to suggest alternative provisions. Employee further states that Employee understands the meaning and import of the terms and provisions of this Agreement, that the Company has not unfairly or unduly influenced Employee to sign this Agreement and that Employee willingly and voluntarily enters into this Agreement as a condition of Employee's employment and for fair and reasonable consideration.*

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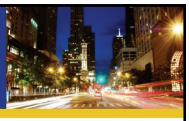

- Reformation and the Blue Pencil Doctrine - Three General Theories
  - All or Nothing
    - If the non-compete is a little overbroad, the whole non-compete is declared unenforceable.
  - Blue Penciling
    - The court deletes grammatically severable provisions only.
    - What does this mean?
  - Reformation
    - The court exercises broad powers to make the non-compete reasonable.

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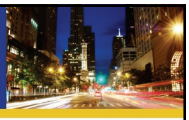

- State/Jurisdiction Differences
  - Modification and Severability Examples
- ***Example 1 (Modification)****: If, at the time of enforcement of any provision of Section _ [Non-Compete Section], a court or arbitrator holds that the restrictions stated therein are unreasonable or unenforceable under circumstances then existing, the Company and Employee agree that the maximum period, scope or geographical area reasonable or permissible under such circumstances will be substituted for the stated period, scope or area*.

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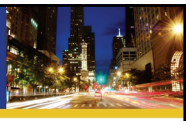

- ***Example 2 (Severability)****: The parties agree that (i) the provisions of this Agreement shall be severable in the event that any of the provisions hereof are for any reason whatsoever invalid, void or otherwise unenforceable, (ii) such invalid, void or otherwise unenforceable provisions shall be automatically replaced by other provisions which are as similar as possible in terms to such invalid, void or otherwise unenforceable provisions but are valid and enforceable and (iii) the remaining provisions shall remain enforceable to the fullest extent permitted by law.*

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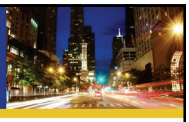
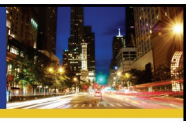


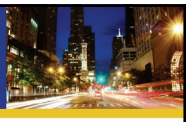
- Step-down Clauses: Are they worth the risk?
  - ***Example:*** *If, at the time of enforcement of any provision of Section _ [Non-Compete Section], a court or arbitrator holds that the restrictions stated therein are unreasonable or unenforceable under circumstances then existing, the Company and Employee agree that the maximum period, scope or geographical area reasonable or permissible under such circumstances shall be as follows: (1) the "Non-Compete Period" shall be amended by substituting the phrase "six (6) months" for "one (1) year" in Section _ [Non-Compete Section]; and (2) the geographic restriction shall be amended by substituting "thirty (30) mile radius" for "fifty (50) mile radius" in Section _ [Non-Compete Section], and, if the court or arbitrator finds "thirty (30) mile radius" to be unreasonable or unenforceable, "ten (10) mile radius" shall be substituted therefore.*

Impact of the Economy



- Context: Balancing of the Harms
- Assessment of the Impact of the Economy
- Response to the Impact of the Economy

Specific Professions



- Physicians
- Broadcasters
- Others

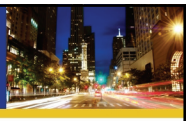
Recent Developments

- Colorado
- Georgia
- Illinois
- Kentucky
- Montana
- New Hampshire
- Ohio
- Oklahoma
- Texas
- Virginia
- Wisconsin

Colorado

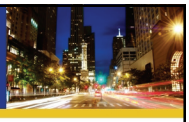
- *Lucht's Concrete Pumping v. Horner*
  - Supreme Court reversed Court of Appeals and found that forbearance from terminating an existing at-will employee (i.e., continued employment) constitutes adequate consideration for a non-competition agreement
  - Similar to recent ruling in Ohio (*Lake Land Employment Group of Akron, LLC*), contrary to recent ruling in Washington state (*Labriola*).

Georgia



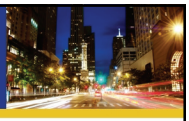
- O.C.G.A. § 13-8-50 et seq.
  - Reasonably restrictive non-competes will be enforceable.
  - Clarity with respect to employment-based noncompetition, customer non-solicitation and employee non-recruitment restrictions.
  - A two-year post-employment non-competition covenant is presumed valid; three-year post-employment customer non-solicitation and employee non-recruitment covenants are presumed valid.
  - Courts shall partially enforce any restrictive covenant so long as there is not "extreme hardship" or the covenant is "not so clearly unreasonable and overreaching in its terms as to be unconscionable." The all-or-nothing approach of Georgia courts has been eliminated.
  - A good faith estimate made prior to termination of the activities of the employee and areas serviced by the employee shall be sufficient for an enforceable covenant, even if such estimate is broader than necessary. There is a mechanism for those bound by covenants to request and receive clarification and for those enforcing a covenant to provide clarification.
  - **Applicable to covenants signed on or after May 11, 2011**
    - ***Becham v. Crosslink Orthopaedics, LLC***

Illinois



- **Illinois Supreme Court Resolves Appellate Court Split Over Viability of Legitimate Business Interest Test**
  - The Illinois Supreme Court has determined that, notwithstanding a 2009 Illinois appellate court decision to the contrary (*Sunbelt Rentals, Inc. v. Ehlers*), Illinois courts must consider whether a former employer's non-compete agreement protects a legitimate business interest. In *Reliable Fire Equipment Co. v. Arrendondo*, the Court reflected on the Fourth District Appellate Court's *Sunbelt* decision and determined that the court in that case "overlooked or misapprehended" the Illinois Supreme Court's extensive body of law on the subject.

Illinois (cont.)



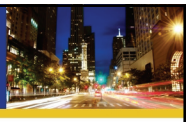
- The Second Circuit disagreed with *Sunbelt* in its opinion in *Reliable Fire*. In its decision, the Second Circuit found, much like the Illinois Supreme Court, that:

  > [C]ontrary to the historical evolution of the law of restrictive covenants, [the *Sunbelt* decision] disallows inquiry into whether the employer has an interest other than suppression of ordinary competition. . . . [T]he *Sunbelt* approach . . . lead[s] to a public policy favoring restrain on trade. Ultimately, we conclude that the legitimate-business-interest test grew out of centuries-old Anglo-American policy against restraint of trade and that there is no reason to abandon it.

- Ultimately, the Illinois Supreme Court "emphatically" disagreed with the Fourth Circuit's *Sunbelt* decision, holding that "[b]ased on this court's extensive precedent, we continue to recognize the legitimate business interest of the promisee as a long-established component in the three-prong rule of reason."

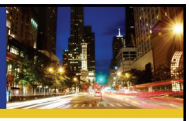
- "However, the two-factor test created in *Kolar*, in which a **near permanent customer relationship** and the **employee's acquisition of confidential information** through his employment are determinative, is no longer valid." Other factors may now be considered.

Illinois (cont.)



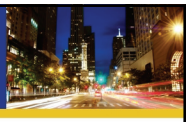
- Post Reliable Fire
  - Hafferkamp v. Llorca: Reliable Fire standards apply retroactively to cases decided under the old law. Practical implication – pre-Reliable Fire cases can be reversed for the circuit court to apply the Reliable Fire test.
  - Kairies v. All Line, Inc.: Reliable Fire did not change old law regarding reasonableness of specific restraints.
  - Gallagher Bassett Svcs., Inc. v. Vacala: held that a five-month continued employment offer was not sufficient consideration for a non-compete.
  - Zabaneh Franchises, LLC v. Walker: Court reversed lower court's decision, finding a client-specific covenant with a two year duration to be reasonable under Reliable Fire.

Kentucky



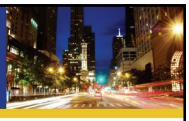
- Charles T. Creech, Inc. v. Brown: Court of appeals outlined factors a Kentucky court should consider in determining the enforceability of an employment-based covenant.
  - 1. Nature of the industry
  - 2. Characteristics of the employer
  - 3. The history of the employer/employee relationship
  - 4. Hardship on the employee
  - 5. Impact on the public

Montana



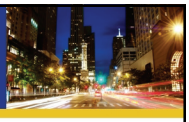
- Wrigg v. Junkermier
  - An employer has no legitimate business interest in enforcing a non-compete against an employee terminated without cause (similar to New York)

New Hampshire



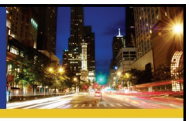
- N.H. Rev. Stat. Ann § 275:70
  - Employers must provide a copy of any "non-compete or non-piracy agreements" new hires or employees who experience a "change in job classification."
  - Law falls in line with similar statutes enacted in other states (see e.g. Ohio).
  - Does not change choice-of-law or enforceability standards.

Ohio



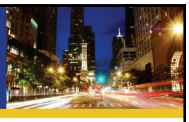
- Acordia of Ohio v. Fishel
  - Supreme Court, in a 4-3 decision, held that where a non-compete does not have specific language assigning its rights to a new company, it will not survive a merger.
  - Court applied the contract as written, which did not provide for assignment.
  - Non-compete began to run when company ceased to exists as a result of merger. Employees left after the covenant expired.
  - Dissent: Ohio merger statute, Ohio Rev. Code 1701.82 and 1705.39, should have controlled; all assets (including the non-compete) should have vested to the surviving entity.

Oklahoma



- Historically, law of non-competes in Oklahoma has been unclear
- Non-competes are generally unenforceable, but non-solicitations may be enforceable if narrowly prescribed (e.g., customer-based, not referral sources; customers employee had contact with, not all company customers)
- Howard v. Nitro-Lift Technologies
  - Refused to modify an overbroad non-compete to make it a non-solicitation covenant

Texas

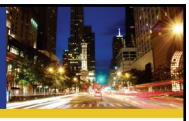


- History Lesson
  - –1989: **TEX. BUS. & COM. CODE § 15.50(a).**

    Notwithstanding section 15.05 of this code, and subject to any applicable provision of Subsection (b), a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.

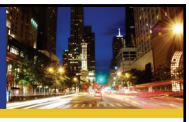
  - –1994: *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 643 (Tex. 1994)
    - Simultaneous Transfer of Training and/or Confidential Information required
  - –2006: *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006)
    - *Light* made it too burdensome to enforce non-competes and misconstrued the statute
    - Training or Confidential Information need not be provided simultaneous to execution of non-compete agreement

Texas (cont.)



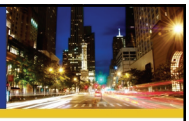
- 2011: **Marsh USA Inc. v. Cook**
  - Continuing trend of employer-friendly holdings
  - Stock options can serve as sufficient additional consideration to support an afterthought covenant
  - Is the door open for bonuses and pay raises?

Virginia



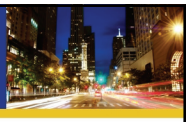
- From an Old Slide of Mine:
  - Virginia – "employee of…"
    - "Where Employee's position and/or services involve or require the performance of duties substantially similar to those Employee performed for the Company"
    - "With a view toward offering or providing Competitive Services to such Company Customer or to the customers of such Company Referral Source"

Virginia – Home Paramount II



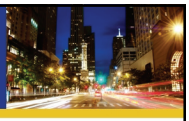
- 1989: Home Paramount I
  - Substantially similar non-compete upheld
- 2011: **Home Paramount Pest Control Cos. Inc. v. Shaffer**
  - Attorney for Home Paramount in the 1989 case represented the defendants in this case
  - Reinvigorated the "janitor" defense
  - Non-compete must be narrowly tailored to the competitive position held by the employee and the knowledge gained from that position
  - Step backward for employers in the Commonwealth

Virginia (cont.)



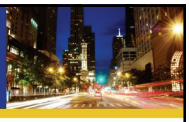
- Hamden v. Total Car Franchising, Corp.: Western District of Virginia found that post-termination obligations were not triggered upon the expiration of a franchise agreement.
  - "Expiration" and "termination" are not synonymous.
  - Challenges surrounding expiration of an agreement rarely come up because most employment contracts are at will.

Wisconsin



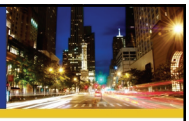
- Key Railroad Development, LLC v. Guido: Court of appeals held that "restrictive covenants in employment contracts" (Wisc. Stat. § 103.465) apply to employees who share equal bargaining power with the company.
  - Court distinguished case involving a stock option agreement not governed by Section 103.465.

Possible Future Developments



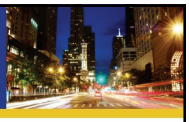
- Massachusetts

Massachusetts



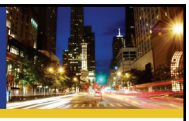
- Three Competing Bills Proposed
  - Two to ban employee non-compete agreements (House Bill 2296 and Senate Bill 932)
  - The other (House Bill 2293) to codify, clarify, and improve the existing complicated and unpredictable common law in this area.

Massachusetts (cont.)



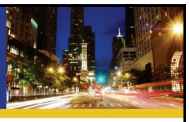
- The Bill to Codify, Clarify and Improve Existing Law:
  - Summary from Russ Beck's blog: http://faircompetitionlaw.com/2011/01/25/massachusetts-noncompete-bill-now-available/
  - The bill, if enacted, will *not* apply retroactively.
  - The bill does *not* affect non-disclosure agreements, non-solicitation agreements, anti-piracy agreements, other similar restrictive covenants, or non-competition agreements outside of the employment context (for example, in the context of the sale of a business). Such agreements are specifically exempted from the scope of the bill.

Massachusetts (cont.)



- The bill codifies current law insofar as non-competition agreements may be enforced if, among other things, they are reasonable in duration, geographic reach, and scope of proscribed activities and necessary to protect the employer's trade secrets, other confidential information, or goodwill. Similarly, courts may continue to reform non-competition agreements to make them enforceable and refuse to enforce such agreements in certain circumstances.
- The bill requires that non-competes be in writing, signed by both parties, and, in most circumstances (*i.e.*, if reasonably feasible), provided to the employee seven business days in advance of employment. If the agreement is required after employment starts, the employee must be provided with notice and "fair and reasonable" consideration (beyond just continued employment).
- The bill limits non-compete agreements to one year, except in the case of garden leave clauses, which may be up to two years.
- The bill identifies certain restrictions that will be presumptively reasonable and therefore enforceable (if all other requirements are met).

Massachusetts (cont.)



- The bill requires payment of the employee's legal fees under certain circumstances, primarily where the agreement is not enforced in most respects by the court or where the employer acted in bad faith. The bill does, however, provide safe harbors for employers to avoid the prospect of having to pay the employee's legal fees:
  - If the non-compete is no more restrictive than the presumptively reasonable restrictions (the safe harbors) set forth in the bill – or if the employer objectively reasonably tried to fit within the safe harbors.

  Similarly, an employer may receive its legal fees, but only if otherwise permitted by statute or contract, the agreement falls within the safe harbor, the non-compete was enforced, and the employee acted in bad faith.
- The bill rejects the inevitable disclosure doctrine (a doctrine by which a court can stop an employee from working for a competitor of the former employer even in the absence of a noncompetition agreement).
- The bill places limitations on forfeiture agreements.

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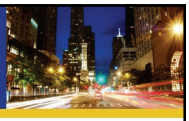

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