

## NOTES

# UNCERTAINTY IN THE EMPLOYMENT CONTEXT: WHICH TYPES OF RESTRICTIVE COVENANTS ARE ENFORCEABLE?

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### INTRODUCTION

Restrictive covenants have become a classic condition of employment, as employers feel the need to protect business interests.<sup>1</sup> Although commonplace, restrictive covenants lead to an overwhelming amount of litigation over enforcement after the employment relationship ends.<sup>2</sup> The parties potentially involved

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<sup>1</sup> See Phillip J. Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not To Compete—A Proposal for Reform*, 57 S. CAL. L. REV. 531, 532 (1984) (commenting that restrictive covenants have “become a standard addition to employment contracts”); Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 723 (2002) (illustrating that “[m]ore and more, employers are requiring employees to sign covenants not to compete and covenants not to disclose confidential information at the outset of an employment relationship”).

<sup>2</sup> See Stone, *supra* note 1, at 738–39 (indicating that a simple online database search reveals that 3206 federal and state cases were litigated in this area from 1995 through 1999). By performing an identical search for 2000 through 2004, one would discover that the amount of federal and state cases has increased to over 4500. It is the uncertainty surrounding each party's rights that makes restrictive covenants a “ripe area of litigation.” Kevin Schlosser, *Litigation Review: Restrictive Covenants Remain Ripe Area of Litigation*, N.Y. L.J., July 27, 2004, at 15–16; see also Kathryn J. Yates, Note, *Consideration for Employee Noncompetition Covenants in Employments at Will*, 54 FORDHAM L. REV. 1123, 1123 (revealing that the “[c]ovenants not to compete have become an increasingly frequent source of employment litigation”); Dana C.M. Peluso, *The Knot Gets a Little Looser*, VA. EMP.

in this type of litigation are the former employer, employee, and prospective employer. An employer can draft any of the following three forms of restrictive covenants: non-competition agreements, which restrict employees from working for competitors;<sup>3</sup> non-solicitation agreements, which limit employees from contacting former clients;<sup>4</sup> or non-disclosure agreements, which prohibit the disclosure of the former employer's proprietary information to the prospective employer.<sup>5</sup>

The reality that there are no clear rules regarding the enforceability of restrictive covenants<sup>6</sup> can be frustrating for an employer that has a vested interest in sustaining its competitive advantage.<sup>7</sup> On the other hand, the employee can also be placed in a vulnerable position,<sup>8</sup> as he or she may have refused other employment offers and may not have the benefit of legal counsel when negotiating the employment contract. Ultimately, the employee may endure unnecessary trepidation over the possibility of losing the employment opportunity if the

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L. LETTER, June 2002 (remarking that a recent Virginia decision invalidating a non-compete agreement "sent shudders down the spines of employers" because the restrictive covenant seemed reasonable).

<sup>3</sup> See, e.g., *Outsource Int'l, Inc. v. Barton*, 192 F.3d 662, 664 (7th Cir. 1999); *A.N. Deringer, Inc. v. Strough*, 103 F.3d 243, 245 (2d Cir. 1996); *Autonation, Inc. v. O'Brien*, 347 F. Supp. 2d 1299, 1302 (S.D. Fla. 2004).

<sup>4</sup> See, e.g., *Benchmark Med. Holdings, Inc. v. Barnes*, 328 F. Supp. 2d 1236, 1240 (M.D. Ala. 2004); *Latona v. Aetna U.S. Healthcare Inc.*, 82 F. Supp. 2d 1089, 1091 (C.D. Cal. 1999); *Hostetler v. Answerthink, Inc.*, 599 S.E.2d 271, 273 (Ga. Ct. App. 2004).

<sup>5</sup> See, e.g., *Safety-Kleen Sys., Inc. v. Hennkens*, 301 F.3d 931, 933-34 (8th Cir. 2002); *Johnson Controls, Inc. v. A.P.T. Critical Sys., Inc.*, 323 F. Supp. 2d 525, 529 (S.D.N.Y. 2004); *LCP Holding Co. v. Taylor*, 817 N.E.2d 439, 441-42 (Ohio Ct. App. 2004). Employees can violate a non-disclosure agreement simply by accepting employment under the inevitable disclosure doctrine, which is "[t]he legal theory that a key employee, once hired by a competitor, cannot avoid misappropriating the former employer's trade secrets." BLACK'S LAW DICTIONARY 792 (8th ed. 2004).

<sup>6</sup> See Greg T. Lembrich, Note, *Garden Leave: A Possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants*, 102 COLUM. L. REV. 2291, 2291 (2002) (noting that "court decisions have failed to provide coherent guidance as to how the enforceability of restrictive covenants is to be determined").

<sup>7</sup> See Stone, *supra* note 1, at 723 (acknowledging that employers believe they grant valuable skills and knowledge to employees); see also David L. Gregory, *Courts in New York Will Enforce Non-Compete Clauses in Contracts Only If They Are Carefully Contoured*, N.Y. ST. B.J., Oct. 2000, at 27 (observing that businesses are vulnerable to computer sabotage by employees).

<sup>8</sup> See Stone, *supra* note 1, at 740 (acknowledging that "[h]istorically, courts were suspicious of noncompete covenants in the employment setting because they believed they were often the result of vastly unequal bargaining power and thus contracts of adhesion"); see also *infra* notes 124-26 and accompanying text.

agreement, which may have little chance of being enforced, is not signed.<sup>9</sup> Although the agreement was formed between the employee and the previous employer, a third party—the prospective employer—may be introduced to litigation if the former employer believes the new employer obtained access to alleged protected interests. Consequently, prospective employers might be cautious about hiring an individual bound by a covenant because they do not wish to become engaged in expensive litigation where priceless proprietary information may be revealed.<sup>10</sup>

In analyzing restrictive covenants in an era of high employee mobility,<sup>11</sup> it is sometimes difficult to rationalize the need for these agreements. This sentiment is reinforced by the notion that restrictive covenants can be contrary to capitalist principles of free-market competition,<sup>12</sup> resulting in numerous courts endorsing invalidation.<sup>13</sup> At the same time, there still exists an employer's countervailing interest in prohibiting former

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<sup>9</sup> See Terry R. Boesch, *What's Really at Issue in Restrictive Covenant Litigation: A Commentary Inspired by Staidl*, 2 EMP. RTS. & EMP. POL'Y J. 439, 439–40 (1998). Employers present new employees with the “typical troika” of restrictive covenants, which the employee blindly signs. *Id.* at 439. The fact that the employer knows the agreement may be invalidated is irrelevant since “the agreements will have already served [the ultimate] purpose” of deterring employees from direct competition. *Id.* at 439–40.

<sup>10</sup> See *id.* at 441–44 (warning that the discovery period may place the new employer in a precarious position in which the employer must choose between employing a recently recruited employee or disclosing precious information).

<sup>11</sup> See Stone, *supra* note 1, at 726–27. In the 1990s, blue-collar males experienced a large decrease in job security. *Id.* at 727. Additionally, the Bureau of Labor Statistics reported that “between 1983 and 1998 there was a significant decline in the percentage of men who [were] with their current employer for ten years or more.” *Id.* at 726; see also Eleanore R. Godfrey, *Inevitable Disclosure of Trade Secrets: Employee Mobility v. Employer's Rights*, 3 J. HIGH TECH. L. 161, 167 (2004) (“Public policy concerns relat[e] to employee mobility and freedom of employment . . . .”); William Safire, Essay, *The New Disloyalty*, N.Y. TIMES, Sept. 26, 1994, at A17 (saying that the phrase “corporate loyalty” elicits consistent reproach).

<sup>12</sup> See Gregory, *supra* note 7, at 27 (commenting that “absolute constraints offend principles of freedom of contract, mobility of workers, and the capitalist political economy favoring vigorous, free competition”).

<sup>13</sup> See, e.g., *Grant v. Carotek, Inc.*, 737 F.2d 410, 411 (4th Cir. 1984) (recognizing that “Virginia law does not look favorably upon restraints”); *Fraser v. Nationwide Mut. Ins. Co.*, 334 F. Supp. 2d 755, 758 (E.D. Pa. 2004) (indicating that these agreements are not favored); *AM Medica Commc'ns Group v. Kilgallen*, 261 F. Supp. 2d 258, 262 (S.D.N.Y. 2003) (acknowledging that the Second Circuit would rather not enforce restrictive covenants), *aff'd*, 90 F. App'x 10 (2d Cir. 2003); *Labor Ready, Inc. v. Abis*, 767 A.2d 936, 942 (Md. Ct. Spec. App. 2001) (emphasizing that these clauses “violate . . . public policy”).

employees from exploiting its information or processes.<sup>14</sup>

The interests of the three parties create a predictable conflict in restrictive covenant enforcement. There are many sources that provide drafting tips for employers,<sup>15</sup> but limited information is available for employees. Restrictive covenants have become very common in the employment context,<sup>16</sup> but do employees really understand the ramifications of what they are signing, and, furthermore, do they have the option of negotiating the terms of these agreements? The purpose of this Note is to bring some understanding as to which types of restrictive covenants are enforceable. Clarification of this area of the law is needed as many employers unfairly present these agreements to employees at the commencement of employment with little or no guidance. To that end, this Note will review the restrictive covenant dispute between employers and employees along with the standards of enforcement in the following manner: Part I will examine enforceability standards with respect to English influences and American law. Part II will discuss how the at-will employment relationship affects restrictive covenants. Part III addresses the areas where restrictive covenants are most practical.

Additionally, this Note asserts that employment lawyers should insist that their clients only use restrictive covenants in the narrowest of cases and tailored to the most unique of employees in an effort to limit the amount of litigation in this area. Too often, employers abuse restrictive covenants to deter all levels of employees from pursuing opportunities with competitors. In a time of job insecurity and in a country that prides itself on the entrepreneurial spirit, it is unfair to limit employees from pursuing their employment goals unless the

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<sup>14</sup> See Stone, *supra* note 1, at 722–23 (recognizing that employees believe skills acquired on the job belong to them, while employers feel they have a right to protect their investment in their employees); Nick Akerman & Andrew B. Lachow, *Trade Secrets Law: Use of Written Agreements*, NAT'L L.J., Dec. 11, 2000, at B5 (noting that non-compete agreements serve a purpose in the area of trade secret protection).

<sup>15</sup> See, e.g., Lynne Anne Anderson & William R. Horwitz, *Restrictive Covenants After Maw*, 176 N.J. L.J. 1033 (2004); Peluso, *supra* note 2; *Properly Structured Covenants Help When Push Comes to Shove*, 14 ENVTL. LABORATORY WASH. REP., June 20, 2003; Diane A. Seltzer, *Goodbye with Caveats: Restrictive Covenants Work Best When Written with an Eye to the Future*, LEGAL TIMES, Apr. 19, 2004, at 47.

<sup>16</sup> See Gregory, *supra* note 7, at 27 (“Employers are more frequently incorporating these restrictive covenants into written contracts that they insist prospective employees sign at the commencement of employment.”).

restriction is protecting a bona fide, legitimate interest.<sup>17</sup>

### I. RESTRICTIVE COVENANT LAW

Restrictive covenants can be traced back to the apprenticeship system,<sup>18</sup> where English courts were initially hostile towards enforcement because these restrictions tended to disadvantage powerless artisans.<sup>19</sup> This rationale continued until *Mitchel v. Reynolds*,<sup>20</sup> in which a baker leased his bakeshop and promised not to compete for the term of the lease.<sup>21</sup> When the baker violated the non-competition agreement, the court ultimately enforced it because the baker agreed to abstain from competing in return for payment of the lease.<sup>22</sup> *Mitchel* provided the framework, which exists today in the American judicial system, for determining whether a restrictive covenant is reasonable under the circumstances to warrant enforcement.<sup>23</sup>

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<sup>17</sup> See *infra* Part III.A.

<sup>18</sup> See Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 632–34 (1960) (noticing that in the apprenticeship system, there were cases of masters unethically restricting apprentices from opportunities to become craftsmen); see also *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388, 712 N.E.2d 1220, 1223, 690 N.Y.S.2d 854, 856 (1999) (indicating that “restrictive covenants go back almost 300 years”).

<sup>19</sup> See Catherine L. Fisk, *Working Knowledge: Trade Secrets, Restrictive Covenants in Employment, and the Rise of Corporate Intellectual Property, 1800–1920*, 52 HASTINGS L.J. 441, 455 (2001) (recognizing that English courts were particularly unreceptive to restrictive covenants in the apprenticeship system and that because an artisan could only pursue one trade, the act of restricting this pursuit was met with disfavor); see also *Outsource Int'l, Inc. v. Barton*, 192 F.3d 662, 669 (7th Cir. 1999) (Posner, C.J., dissenting) (highlighting that the English common law was against enforcement because “workers would be tricked into agreeing to covenants that would . . . propel them into destitution”).

<sup>20</sup> 24 Eng. Rep. 347 (1711).

<sup>21</sup> See Blake, *supra* note 18, at 629 (summarizing the facts in *Mitchel*, 24 Eng. Rep. 347).

<sup>22</sup> See *id.*

<sup>23</sup> See Fisk, *supra* note 19, at 456 (revealing that “*Mitchel* established a multifaceted analysis of reasonableness that has ever since dominated the law’s approach to contractual restraints on the practice of a trade and thus to the dissemination of workplace knowledge”); see also Blake, *supra* note 18, at 630–31. The English court provided a sophisticated analysis to determine the reasonableness of restrictive covenants by weighing a specific, tailored restraint versus broad, indefinite restraints. *Id.* (reviewing the opinion in *Mitchel*, 24 Eng. Rep. 347); see also *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 69 (2d Cir. 1999) for a description of *Mitchel*.

Since this opinion, courts have been influenced by the reasonableness doctrine in determining the enforceability of restrictive covenants. See, e.g., *Grant v. Carotek, Inc.*, 737 F.2d 410, 412 (4th Cir. 1984); *Labor Ready, Inc. v. Abis*, 767 A.2d 936, 942

Today in the United States, twenty states have drafted statutes governing the enforceability of restrictive covenants.<sup>24</sup> The *Restatement* provides a realistic picture of how some legislatures and courts analyze restrictive covenants,<sup>25</sup> but it is helpful to review the statutes and standards to understand why employers and employees consistently choose to litigate over this issue.

#### A. State Statutes

This Note will assign the twenty existing state restrictive covenant statutes to four categories. The first and most common category, which includes eight statutes (those of Alabama, California, Michigan, Montana, North Dakota, Oklahoma, Tennessee, and West Virginia), consists of statutes providing clear public policy language but offering no guidance to courts on what will render a restrictive covenant enforceable.<sup>26</sup> The second category examines statutes providing specific criteria for courts to utilize when analyzing restrictive covenants and includes four statutes (those of Florida, Oregon, Texas, and Wisconsin).<sup>27</sup> The third category analyzes statutes with detailed exceptions to

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(Md. Ct. Spec. App. 2001); *BDO Seidman*, 93 N.Y.2d at 388–89, 712 N.E.2d at 1223, 690 N.Y.S.2d at 856–57.

<sup>24</sup> The following twenty states have statutes governing restrictive covenants: Alabama, California, Colorado, Florida, Georgia, Hawaii, Louisiana, Michigan, Missouri, Montana, Nevada, North Carolina, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, West Virginia, and Wisconsin. See BRIAN M. MALSBERGER, COVENANTS NOT TO COMPETE: A STATE-BY-STATE SURVEY (Samuel M. Brock, III & Arnold H. Pedowitz eds., 4th ed. 2004). Ohio's statute "addresses contracts and combinations that restrain trade," but Ohio courts do not apply it in the area of employment non-competes. *Id.* at 2623; see OHIO REV. CODE ANN. § 1331.02 (LexisNexis 2002).

<sup>25</sup> RESTATEMENT (SECOND) OF CONTRACTS, § 188 (1981). A restrictive covenant will be found unreasonable if "the restraint is greater than is needed to protect the promisee's legitimate interest, or . . . the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public." *Id.* § 188(1)(a)–(b). Under this standard, the employer has the burden of proving that the restriction is necessary to protect a legitimate interest, and if it is, the following relationships can be regulated: business seller-buyer, employer-employee, and former partnership. See *id.* § 188(2).

<sup>26</sup> See ALA. CODE § 8-1-1 (LexisNexis 2002); CAL. BUS. & PROF. CODE §§ 16600–16602 (Deering 1992 & Supp. 2005); MICH. COMP. LAWS SERV. § 445.772 (LexisNexis 2001); MONT. CODE ANN. §§ 28-2-703 to 28-2-705 (2003); N.D. CENT. CODE § 9-08-06 (1987); OKLA. STAT. ANN. tit. 15, §§ 217–219 (West 1993 & Supp. 2004); TENN. CODE ANN. § 47-25-101 (2001); W. VA. CODE ANN. § 47-18-3 (LexisNexis 1999).

<sup>27</sup> See FLA. STAT. ANN. § 542.335 (West 2002); OR. REV. STAT. § 653.295 (2003); TEX. BUS. & COM. CODE ANN. §§ 15.50–15.52 (Vernon 2002); WIS. STAT. ANN. § 103.465 (West 2002).

public policy, which allow for broad interpretation and incorporates five statutes (those of Colorado, Hawaii, Louisiana, Missouri, and Nevada).<sup>28</sup> The final category reviews three statutes (those of Georgia, North Carolina, and South Dakota)<sup>29</sup> that seem to favor the enforcement of restrictive covenants.

1. Statutes with Unmistakable Public Policy Language But No Criteria for Enforcement

California's statute exemplifies the first category as it urges that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."<sup>30</sup> With this statute, California asserts the policy that any contract restricting an individual from the opportunity to earn a living will be considered unenforceable. There are two statutory exceptions that allow restrictive covenants for sale of businesses<sup>31</sup> and partnership dissolutions.<sup>32</sup> Alabama, Montana, North Dakota, and Oklahoma provide similar public policy language and the two exceptions supporting enforcement.<sup>33</sup> Michigan,<sup>34</sup> Tennessee,<sup>35</sup> and West Virginia<sup>36</sup> enacted comparable

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<sup>28</sup> See COLO. REV. STAT. § 8-2-113 (2004); HAW. REV. STAT. ANN. § 480-4 (LexisNexis 2002); LA. REV. STAT. ANN. § 23:921 (Supp. 2005); MO. ANN. STAT. § 431.202 (West Supp. 2004); NEV. REV. STAT. ANN. § 613.200 (LexisNexis Supp. 2003).

<sup>29</sup> See GA. CODE ANN. § 13-8-2.1 (Supp. 2005); N.C. GEN. STAT. § 75-4 (2003); S.D. CODIFIED LAWS § 53-9-11 (2004).

<sup>30</sup> CAL. BUS. & PROF. CODE § 16600.

<sup>31</sup> *Id.* § 16601. Under the sale of business exception, a restrictive covenant will be enforced where the seller has agreed

with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein.

*Id.*

<sup>32</sup> *Id.* § 16602. The partnership dissolution exception provides that:

(a) Any partner may, upon or in anticipation of any of the circumstances described in subdivision (b), agree that he or she will not carry on a similar business within a specified geographic area where the partnership business has been transacted, so long as any other member of the partnership, or any person deriving title to the business or its goodwill from any such other member of the partnership, carries on a like business therein.

*Id.*

<sup>33</sup> See ALA. CODE § 8-1-1 (LexisNexis 2002); MONT. CODE ANN. §§ 28-2-703 to 28-2-705 (2003); N.D. CENT. CODE § 9-08-06 (1987); OKLA. STAT. ANN. tit. 15, §§ 217-219 (West 1993 & Supp. 2004).

<sup>34</sup> MICH. COMP. LAWS SERV. § 445.772 (LexisNexis 2001).

legislation, but these statutes are not limited to the employment context. Michigan leaves the prohibition open ended, as a restrictive covenant can be deemed void in any "relevant market."<sup>37</sup> Likewise, Tennessee's statute bars restrictive covenants in "[a]ll arrangements, contracts, agreements, trusts, or combinations between persons or corporations,"<sup>38</sup> while West Virginia covers, "[e]very contract" or "combination in the form of trust."<sup>39</sup>

## 2. Statutes Providing Specific Criteria for Enforcement

The second category, those statutes providing standards in determining enforceability, includes Texas, Wisconsin, Florida, and Oregon. The first, Texas, actually requires that courts follow the guidance set forth in its statute.<sup>40</sup> The criteria provide that a restrictive covenant will be enforced if it is signed as a supplement or as part of the original agreement; possesses reasonable limitations in geography, duration, and the scope of activity; and "[does] not impose a greater restraint than is necessary to protect" the employer.<sup>41</sup> In addition, this statute allows courts to modify unreasonable terms rather than invalidating the entire restrictive covenant.<sup>42</sup> Wisconsin, although not expressly requiring its courts to utilize its statutory guidelines, will enforce restrictive covenants "if the restrictions imposed are reasonably necessary for the protection of the employer."<sup>43</sup>

Florida illustrates the characteristics of the second category by providing a long list of criteria for enforcement,<sup>44</sup> a non-

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<sup>35</sup> TENN. CODE ANN. § 47-25-101 (2001).

<sup>36</sup> W. VA. CODE ANN. § 47-18-3 (LexisNexis 1999).

<sup>37</sup> MICH. COMP. LAWS SERV. § 445.772.

<sup>38</sup> TENN. CODE ANN. § 47-25-101.

<sup>39</sup> W. VA. CODE ANN. § 47-18-3.

<sup>40</sup> TEX. BUS. & COM. CODE ANN. § 15.52 (Vernon 2002). "The criteria for enforceability of a covenant not to compete . . . and the procedures and remedies in an action to enforce a covenant not to compete provided by . . . this code are exclusive and preempt any other criteria for enforceability of a covenant not to compete . . . ." *Id.*

<sup>41</sup> *Id.* § 15.50(a).

<sup>42</sup> *Id.* § 15.51(c).

<sup>43</sup> WIS. STAT. ANN. § 103.465 (West 2002).

<sup>44</sup> See FLA. STAT. ANN. § 542.335 (West 2002). In summary, the elements for enforcement include: (1) an agreement "set forth in a writing signed by the person against whom enforcement is sought"; (2) the protection of a "legitimate business interest"; (3) a restriction reasonable in "time, area, and line of business." *Id.*

exhaustive record of what is considered a “legitimate business interest,”<sup>45</sup> and guidelines for reasonable temporal limits.<sup>46</sup> Even with these extensive parameters, critics believe the statute still leads to unpredictable results, particularly because the determination of a legitimate business interest must be resolved on a case-by-case basis.<sup>47</sup> Lastly, Oregon provides requirements for enforcement<sup>48</sup> and also mentions trade secrets but does not offer concrete examples.<sup>49</sup>

### 3. Statutes with Unmistakable Public Policy Language and Additional Exceptions

The third category, those statutes with public policy concerns and detailed exceptions to barring enforcement of restrictive covenants, includes Louisiana, Hawaii, Missouri, Colorado, and Nevada. The opening section of Louisiana’s statute is similar to its counterparts in the first category<sup>50</sup> but then indicates that restrictive covenants less than two years in duration may be formed with employees and independent contractors.<sup>51</sup> Similarly, Hawaii follows its public policy assertion with an exception for trade secrets.<sup>52</sup> Lastly, Missouri exempts trade secrets, confidential information, and client contacts<sup>53</sup> but leaves the

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<sup>45</sup> *Id.* § 542.335(1)(b). Legitimate business interests include “[t]rade secrets, . . . [v]aluable confidential business or professional information that otherwise does not qualify as trade secrets, . . . [s]ubstantial relationships with specific prospective or existing customers, patients, or clients, . . . [c]ustomer, patient, or client goodwill, [and] . . . [e]xtraordinary or specialized training.” *Id.*

<sup>46</sup> *See id.* § 542.335(1)(d)–(e). Temporal limits differ depending on whether the subject is a former employee, former distributor, or seller. *Id.*

<sup>47</sup> *See* E. John Wagner, *Striking a Balance?: The Florida Legislature Adopts an Unfair Competition Approach to Restrictive Covenants*, 49 FLA. L. REV. 81, 110 (1997) (declaring that the uncertainty over determinations of an employer’s legitimate business interest “will prevent [the act] from providing the predictable results its drafters sought to achieve”).

<sup>48</sup> *See* OR. REV. STAT. § 653.295 (2003). “(1) A noncompetition agreement . . . is void and shall not be enforced by any court in this state unless the agreement is entered into upon the: (a) [i]nitial employment of the employee with the employer; or (b) [s]ubsequent bona fide advancement of the employee with the employer.” *Id.*

<sup>49</sup> *Id.* § 653.295(5).

<sup>50</sup> *See* LA. REV. STAT. ANN. § 23:921 (Supp. 2005). The introductory section to this statute is very similar to California’s and also includes the sale of business and partnership exceptions. *Id.* § 23:921(B)–(C).

<sup>51</sup> *Id.* § 23:921(C).

<sup>52</sup> HAW. REV. STAT. ANN. § 480-4 (LexisNexis 2002).

<sup>53</sup> MO. ANN. STAT. § 431.202 (West Supp. 2005).

interpretation and standards to the courts.<sup>54</sup>

The other statutes within the third category, Colorado<sup>55</sup> and Nevada,<sup>56</sup> provide strong language prohibiting employers from preventing an employee's pursuit of an occupation but list several exceptions that seem to weaken the bite of the state's policy. For instance, Colorado's statute opens with "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"<sup>57</sup> but then allows for enforcement where the covenant protects trade secrets, employee training of less than two years, and executive management positions.<sup>58</sup> Similarly, Nevada imposes strict penalties for restricting employees<sup>59</sup> but does not prohibit non-compete agreements that restrain employees from "pursuing a similar vocation in competition with" the former employer or non-disclosure agreements protecting trade secrets.<sup>60</sup> Although initially these statutes seem to benefit the employee, the exceptions, in an attempt to provide impartial language, leave a lot of discretion to the courts.

#### 4. Statutes Favoring Enforcement

The final category presents three statutes that seem to support enforcement of restrictive covenants. First, South Dakota allows non-competition and non-solicitation agreements for periods of less than two years.<sup>61</sup> Unlike other statutes, enforcement may simply depend on whether the employee signed the agreement.<sup>62</sup> Similarly, North Carolina enforces restrictive covenants as long as they are in writing and signed by the

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<sup>54</sup> See, e.g., *Safety-Kleen Sys., Inc. v. Hennkens*, 301 F.3d 931, 937 (8th Cir. 2002) (indicating that "[t]he Missouri courts have frequently held that . . . substantial and individualized customer contacts are a protectable interest").

<sup>55</sup> COLO. REV. STAT. § 8-2-113 (2004).

<sup>56</sup> NEV. REV. STAT. ANN. § 613.200 (LexisNexis Supp. 2003).

<sup>57</sup> COLO. REV. STAT. § 8-2-113(2).

<sup>58</sup> *Id.* § 8-2-113(2)(b)-(d).

<sup>59</sup> See NEV. REV. STAT. ANN. § 613.200(1). In Nevada, an employer that restricts an employee from gaining employment will be "guilty of a gross misdemeanor and shall be punished by a fine of not more than \$5,000." *Id.*

<sup>60</sup> *Id.* § 613.200(4)(a)-(b).

<sup>61</sup> See S.D. CODIFIED LAWS § 53-9-11 (2004).

<sup>62</sup> See *id.* The language states, "[a]n employee may agree with an employer at the time of employment" to execute a non-competition or non-solicitation agreement. *Id.* (emphasis added).

employee.<sup>63</sup>

Georgia enacted one of the more detailed statutes concerning restrictive covenants.<sup>64</sup> This statute explicitly states that reasonable restrictive covenants are compatible with public policy notions.<sup>65</sup> Reasonable durational limits vary between two and three years depending on the restricted activity.<sup>66</sup> The statute also provides that an employer only has to predict in good faith which post-employment activities need to be restricted at the time of termination.<sup>67</sup> Ultimately, a broad restrictive covenant can be narrowly tailored to the specific opportunity the terminated employee is pursuing. Furthermore, similar to the law in Texas, Georgia courts are directed to modify partial restraints of trade by severing any unreasonable terms.<sup>68</sup>

### *B. Conflicts Between State Restrictive Covenant Laws*

In a time of employee mobility,<sup>69</sup> it is common for employees to travel interstate to acquire new positions, which frequently creates conflict among state laws.<sup>70</sup> Under section 187 of the *Restatement of Conflict of Laws*, although parties may include forum selection clauses, courts may view such provisions as being contrary to state public policies.<sup>71</sup> Furthermore, a court will disregard the parties' agreed choice of law in two cases: (1)

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<sup>63</sup> See N.C. GEN. STAT. ANN. § 75-4 (West 2003). North Carolina allows enforcement when the "agreement is in writing duly signed by the party who agrees not to enter into any such business within such territory." *Id.* (emphasis added).

<sup>64</sup> See GA. CODE ANN. § 13-8-2.1 (Supp. 2005).

<sup>65</sup> *Id.* § 13-8-2.1(a). "Contracts that restrain in a reasonable manner . . . are contracts in partial restraint of trade and shall not be considered against the policy of the law, and such partial restraints, so long as otherwise lawful, shall be enforceable for all purposes." *Id.*

<sup>66</sup> See *id.* § 13-8-2.1(c)(2)–(6). The following time limits apply: two years or less for competitive activities and three years or less for soliciting former clients or recruiting other employees. *Id.*

<sup>67</sup> *Id.* § 13-8-2.1(e)(2). "The post-employment covenant shall be construed ultimately to cover only so much of such estimate as relates to the activities actually conducted, the products and services actually offered, or the areas actually involved within a stated period of time prior to termination." *Id.*

<sup>68</sup> *Id.* § 13-8-2.1(g)(2)(3).

<sup>69</sup> See *supra* note 11 and accompanying text.

<sup>70</sup> See Mark A. Kahn, *Trade Secret: Non-Compete Agreements: California Law: Application Group, Inc. v. Hunter Group, Inc.*, 14 BERKELEY TECH. L.J. 283, 283 (1999) (commenting that each state has its own rules for restrictive covenants, and judgments will sometimes supersede the laws of one state in a situation where the standards clash).

<sup>71</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1989).

where the chosen state does not possess a "substantial relationship to the parties" or (2) where the agreed law would be contrary to the state law most related to the transaction.<sup>72</sup>

The first exception, as opposed to the second exception, is somewhat straightforward due to guidance under section 188 of the *Restatement*. This section provides five contacts to be considered in determining a substantial state relationship: "(a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties."<sup>73</sup> The second exception is not as clear, and therefore warrants further review. For example, in *Application Group, Inc., v. Hunter Group, Inc.*,<sup>74</sup> the employee signed a non-compete agreement in Maryland but later resigned and acquired a new position with a competitor in California.<sup>75</sup> Due to the companies' differing principal places of business, a choice of law conflict arose based on Maryland's flexibility in enforcing restrictive covenants<sup>76</sup> as compared to California's strong public policy

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<sup>72</sup> *Id.* § 187(2)(a)–(b). The relevant portion of the *Restatement* concerning exceptions to the parties' choice of law specifies:

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, 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 law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and . . . would be the state of the applicable law in the absence of an effective choice of law by the parties.

*Id.*

<sup>73</sup> *Id.* § 188(2) (1971). Several courts have adopted this standard to determine a state law's relation to the restrictive covenant. *See, e.g.*, *Budget Rent A Car Corp. v. G & M Truck Rental*, No. 03C2434, 2003 U.S. Dist. LEXIS 11323, at \*14–15 (N.D. Ill. June 26, 2003), *vacated as moot*, 2003 U.S. Dist. LEXIS 24009 (N.D. Ill. Dec. 21, 2003); *Standard Register Co. v. Cleaver*, 30 F. Supp. 2d 1084, 1092 (N.D. Ind. 1998).

<sup>74</sup> 72 Cal. Rptr. 2d 73 (Ct. App. 1998).

<sup>75</sup> *Id.* at 76.

<sup>76</sup> *See Ancora Capital & Mgmt. Group v. Gray*, 55 Fed. App'x 111, 112 (4th Cir. 2003) (granting a preliminary injunction to the employer in order to prohibit the former employee from continuing to work for a competitor); Kahn, *supra* note 70, at 291–92 (revealing that restrictive covenants are generally held to be valid under Maryland law, though there are restrictions placed on the employer's ability to

against enforcement.<sup>77</sup> Ultimately, the court applied California law, finding that California would face greater injury if its laws were subordinated to Maryland's.<sup>78</sup>

This decision may have its opponents,<sup>79</sup> but other courts have followed the same reasoning. For example, Massachusetts courts typically respect the parties' choice of law unless a different state has a "materially greater interest" in determining enforceability.<sup>80</sup> Alabama is more stringent as it refuses to apply a different state's law if the restrictive covenant is unenforceable under Alabama law.<sup>81</sup> Likewise, Georgia simply will not apply a state law that may be harmful to Georgia's interests concerning restrictive covenants.<sup>82</sup>

### C. State Court Standards

It is encouraged that the parties in an employment relationship understand how states without statutes governing restrictive covenants evaluate such agreements.<sup>83</sup> Typically, the

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enforce them).

<sup>77</sup> See CAL. BUS. & PROF. CODE § 16600 (Deering 1992 & Supp. 2005); see also *Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp. 2d 1089, 1093 (C.D. Cal. 1999); *D'Sa v. Playhut, Inc.*, 102 Cal. Rptr. 2d 495, 498 (Ct. App. 2000); *Muggill v. Reuben H. Donnelley Corp.*, 398 P.2d 147, 149 (1965); Chiara F. Orsini, *Protecting an Employer's Human Capital: Covenants Not to Compete and the Changing Business Environment*, 62 U. PITT. L. REV. 175, 192 (2000) (revealing that choice of law provisions are typically not recognized when facing California's restrictive covenant law).

<sup>78</sup> *Application Group, Inc. v. Hunter Group, Inc.*, 72 Cal. Rptr. 2d 73, 86 (Ct. App. 1998). The Court of Appeal of California read the second exception of the *Restatement* as an authorization to ignore a choice of law provision in exchange for the preservation of the state's public policy. Applying this reasoning, the court was "convinced that California ha[d] a materially greater interest than . . . Maryland in the application of its law to the parties' dispute, and that California's interests would be more seriously impaired if its policy were subordinated to the policy of Maryland." *Id.*

<sup>79</sup> See Kahn, *supra* note 70, at 289 (describing the court's decision to apply California over Maryland law as a "fundamental error").

<sup>80</sup> See *Oxford Global Res., Inc. v. Guerriero*, No. 03-12078-DPW, 2003 U.S. Dist. LEXIS 23503, at \*13 (D. Mass. Dec. 30, 2003) ("In general, Massachusetts respects contractual choice of law provisions.").

<sup>81</sup> See *Benchmark Med. Holdings, Inc. v. Barnes*, 328 F. Supp. 2d 1236, 1242 (M.D. Ala. 2004) ("Alabama courts . . . will not apply another state's law if the covenant not to compete is void under Alabama law.").

<sup>82</sup> See *Keener v. Convergys Corp.*, 342 F.3d 1264, 1269 (11th Cir. 2003) ("[Georgia] will apply its own law to any agreements against its public policy . . .").

<sup>83</sup> This section presents a sampling of state standards in order to illustrate some of the differences in restrictive covenant standards. For a more comprehensive study concerning state restrictive covenant standards, see MALSBERGER, *supra* note 24.

first hurdle in enforcing restrictive covenants is based on the reasonableness of the geographical and temporal limits in light of the employment circumstances.<sup>84</sup> The second hurdle traditionally reviews whether the employer possesses a legitimate reason for restricting the employee.<sup>85</sup>

#### 1. First Hurdle: Reasonable Geographic and Durational Limits

Courts have different standards for what is considered a reasonable geographic boundary for the regulated activity. One instructive case defined a proper geographic limit as one that is “well-defined and no greater than what is required to protect the employer’s business or goodwill.”<sup>86</sup> The determination of what constitutes a proper geographic limit varies, but there are conventional guidelines.

First, if there are no explicit geographical limits, courts have typically found the entire restrictive covenant unenforceable<sup>87</sup> unless they have chosen to modify the covenant using the blue-

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<sup>84</sup> See, e.g., *Liataud v. Liataud*, 221 F.3d 981, 985 (7th Cir. 2000) (emphasizing that “[t]o be enforceable, . . . the agreement must be reasonable in time, in geographical scope, and in the activities restricted”); *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 70 (2d Cir. 1999) (noting the enforceability of a restrictive covenant will be based on whether it is “reasonable in time and geographic scope” and depends on “the facts of each case”); see also *D.O.T. Tiedown & Lifting Equip., Inc. v. Wright*, 272 A.D.2d 290, 290–91, 707 N.Y.S.2d 893, 894 (2d Dep’t 2000) (holding that a restrictive covenant with geographical and durational limits was not unreasonable or a product of overreaching).

<sup>85</sup> See, e.g., *Outsource Int’l, Inc. v. Barton*, 192 F.3d 662, 666 (7th Cir. 1999) (applying the state standard to determine if “[the] employer ha[d] a legitimate business interest to justify enforcement of a covenant”); *Fraser v. Nationwide Mut. Ins. Co.*, 334 F. Supp. 2d 755, 758 (E.D. Pa. 2004) (recognizing that “[a] necessary prerequisite . . . is the existence of a protectible business interest”); *Rockford Mfg., Ltd. v. Bennet*, 296 F. Supp. 2d 681, 686 (D.S.C. 2003) (reasoning that one of the factors to balance is whether the restrictive covenant “is necessary for the protection of the legitimate interest of the employer”); *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388, 712 N.E.2d 1220, 1223, 690 N.Y.S.2d 854, 856–57 (1999) (holding that a covenant should be enforced to the extent that it is “no greater than is required for the protection of the legitimate interest of the employer”).

<sup>86</sup> *Labor Ready, Inc. v. Abis*, 767 A.2d 936, 943 (Md. Ct. Spec. App. 2001); see also *Hebb v. Stump, Harvey & Cook, Inc.*, 334 A.2d 563, 569 (Md. Ct. Spec. App. 1975) (noting that “a covenant not to compete, which is over-broad as to area, will not be enforced”).

<sup>87</sup> See *Liataud*, 221 F.3d at 987 (applying Illinois law and concluding that restricting a sandwich-shop owner from opening a store anywhere outside of the city of Madison, Wisconsin was unreasonable and overbroad because no other geographical limits existed in the restrictive covenant); *Int’l Paper Co. v. Brooks*, 63 Va. Cir. 494, 496–97 (Va. Cir. Ct. 2003) (finding that an agreement cannot have open-ended geographic and durational limits).

pencil method to retain the reasonable portions.<sup>88</sup> Second, courts have found restrictive covenants with geographical limits covering one state or less to be reasonable.<sup>89</sup> Lastly, courts have also tolerated restrictive covenants that are conditioned on the employer's regional client base.<sup>90</sup> Under this qualification, the employee could conceivably be banned from soliciting clients throughout the country, thus leading to unpredictable results in enforcement.<sup>91</sup>

As opposed to the various approaches used with geographic boundaries, courts are more consistent with temporal limits. Similar to limitless geographical restraints, provisions drafted without expiration will render a restrictive covenant invalid.<sup>92</sup> The common threshold courts follow for durational purposes is two years or less.<sup>93</sup>

## 2. Second Hurdle: "Legitimate" Interest

Under the second hurdle, the determination of what

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<sup>88</sup> See *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 215 (Ind. Ct. App. 1982) (applying the blue-pencil doctrine to enforce the restrictive covenant "to the extent of its legally acceptable terms"). *But see* *LCP Holding Co. v. Taylor*, 817 N.E.2d 439, 446 (Ohio Ct. App. 2004) ("Although a trial court may modify an unreasonable restrictive covenant to make it reasonable and enforceable, it is not required to do so.").

<sup>89</sup> See *Safety-Kleen Sys., Inc. v. Hennkens*, 301 F.3d 931, 934, 937 (8th Cir. 2002) (upholding a restrictive covenant limiting employee within Missouri without utilizing the state statute); *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 66, 73 (2d Cir. 1999) (enforcing a restrictive covenant that prohibited a title insurance salesman from competing in the state of New York); *see also* *A.N. Deringer, Inc. v. Strough*, 103 F.3d 243, 244–45, 249 (2d Cir. 1996) (applying Vermont law to allow a restrictive covenant that covered a one-hundred-mile radius); *Stiepleman Coverage Corp. v. Raifman*, 258 A.D.2d 515, 515–16, 685 N.Y.S.2d 283, 284–85 (2d Dep't 1999) (finding a fifty-mile radius reasonable).

<sup>90</sup> See *Rockford Mfg., Ltd. v. Bennet*, 296 F. Supp. 2d 681, 689–90 (D.S.C. 2003) (allowing that restrictions from contacting customers may be used as a substitute); *see also* *Medtronic, Inc. v. Gibbons*, 684 F.2d 565, 566 (8th Cir. 1982) (permitting the employer to limit an employee from contacting existing customers).

<sup>91</sup> See *Am. Fid. Assurance Corp. v. Leonard*, 81 F. Supp. 2d 1115, 1120–21 (D. Kan. 2000) (modifying a geographical limitation of existing clients to strictly the employee's former sales territory of nine counties); *see also* *Seach*, 439 N.E.2d at 215 (restricting the employee from soliciting present clients). *But see* *LCP Holding Co.*, 817 N.E.2d at 446–47 (refusing to modify an agreement with limitless boundaries).

<sup>92</sup> See, e.g., *Liataud*, 221 F.3d at 987 (finding the lack of a "temporal restriction" to be unfair to the defendant).

<sup>93</sup> See, e.g., *Rockford Mfg., Ltd.*, 296 F. Supp. 2d at 689 (highlighting that two years is reasonable as "[c]ovenants of comparable duration have been regularly upheld"); *Am. Fid. Assurance Corp.*, 81 F. Supp. 2d at 1120; *Stiepleman Coverage Corp.*, 258 A.D.2d at 515, 685 N.Y.S.2d at 284.

constitutes an employer's legitimate interest involves a thorough analysis by courts. The degree of authenticity of the business interest will influence a court's judgment on the reasonableness of the geographic and durational limits. In Illinois, courts allow employers to protect different types of interests: (1) customer relationships that exist solely due to the employee's connection to the employer and (2) confidential information obtained from the employer and utilized by the employee post-termination.<sup>94</sup> In order to determine the first type, Illinois courts choose between two tests, consisting of either a standard that balances seven factors relating to the history, quality, and extent of the client contact<sup>95</sup> or a test that inquires whether the business in question warrants protection.<sup>96</sup> Illinois courts typically use the latter standard, referred to as "the nature of the business test," to review whether the employer's product is specialized and if the company's success is dependent on long-term customer loyalty.<sup>97</sup> If the company cannot easily be tested by this method, a court can utilize the seven-factor test, but it is not mandatory that they do so.<sup>98</sup> The second area, protection of confidential information,

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<sup>94</sup> See *Outsource Int'l, Inc. v. Barton*, 192 F.3d 662, 666 (7th Cir. 1999). Illinois courts recognize two situations that will justify enforcement of a restrictive covenant: "(1) where the customer relationships are near-permanent and but for the employee's association with the employer the employee would not have had contact with the customers; and (2) where the former employee acquired trade secrets . . . and subsequently tried to use it for his own benefit." *Id.*; see also *Lawrence & Allen, Inc. v. Cambridge Human Res. Group, Inc.*, 685 N.E.2d 434, 443 (Ill. App. Ct. 1997).

<sup>95</sup> See *Agrimerica, Inc. v. Mathes*, 557 N.E.2d 357, 363 (Ill. App. Ct. 1990). The seven objective factors are:

- (1) the number of years required to develop the clientele;
- (2) the amount of money invested to acquire clients;
- (3) the degree of difficulty in acquiring clients;
- (4) the extent of personal contact by the employee;
- (5) the extent of the employer's knowledge of its clients;
- (6) the duration of the customers' association with the employer; and
- (7) the continuity of employer-customer relationships.

*Id.*

<sup>96</sup> See *Outsource Int'l, Inc.*, 192 F.3d at 667 (reviewing the nature of the business test which determines if the employer has a legitimate interest).

<sup>97</sup> *Id.* The Seventh Circuit opined that "certain businesses are . . . more amenable to success under it." *Id.* (quoting *Lawrence & Allen, Inc.*, 685 N.E.2d at 444). For example, a company involved in professional services, where revenues are contingent on long-term relationships, will more likely have a legitimate reason for protecting business interests as opposed to a company focusing on sales, where there is a consistent turnover of clients. *Id.*

<sup>98</sup> See *Springfield Rare Coin Galleries, Inc. v. Mileham*, 620 N.E.2d 479, 490 (Ill. App. Ct. 1993). The trial court determined that the restrictive covenant was not

is satisfied through two steps. First, the employer must prove that the employee accessed this information while employed and then tried to utilize it after termination.<sup>99</sup> Second, regardless of whether this is accurate, the employer must demonstrate that the confidential information is worth protecting through the means of a restrictive covenant.<sup>100</sup> Similar to Illinois, Minnesota courts stipulate that the second step is only achieved if the restrictive covenant “protect[s] a legitimate interest of the employer.”<sup>101</sup>

Much like the approach outlined in the *Restatement*, New York applies a three-prong reasonableness standard that finds a restrictive covenant enforceable “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.”<sup>102</sup> Under the first factor, a legitimate interest may include customer relationships,<sup>103</sup> unique services,<sup>104</sup> or confidential customer information.<sup>105</sup> Similar to

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enforceable because the type of business—rare coins and metals—fell under the sales category and, therefore, did not involve the type of client relationship that should be protected. The employer, on appeal, argued that the seven-factor test should have been applied, but the court concluded this was unnecessary because the particular business fell “squarely within one of the two categories . . . [the] court ha[d] previously recognized.” *Id.*

<sup>99</sup> See *id.* at 485.

<sup>100</sup> See *Outsource Int'l, Inc.*, 192 F.3d at 669 (finding the employer had legitimate trade secrets based on its effort in “maintain[ing] classified records on its customers”); see also *Springfield Rare Coin Galleries, Inc.*, 620 N.E.2d at 485 (reminding that “customer lists and other customer information will constitute confidential information *only* when the information has been developed by the employer over a number of years at great expense and kept under tight security”).

<sup>101</sup> *Medtronic, Inc. v. Gibbons*, 684 F.2d 565, 568 (8th Cir. 1982) (including trade secrets and confidential information within the parameters of a legitimate interest).

<sup>102</sup> *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388–89, 712 N.E.2d 1220, 1223, 690 N.Y.S.2d 854, 856–57 (1999) (emphasis omitted).

<sup>103</sup> See *id.* at 392, 712 N.E.2d at 1225, 690 N.Y.S.2d at 859. The Court of Appeals determined that existing customer relationships were fundamental to the operation of the employer’s accounting business and therefore, were a legitimate interest of the firm. *Id.*; see also *Rockford Mfg., Ltd. v. Bennet*, 296 F. Supp. 2d 681, 686 (D.S.C. 2003). The South Carolina courts agree with this rationale and recognize that a company’s customer base is the most important asset to the business. *Id.* But see *Colonize.com, Inc. v. Perlow*, No. 03-CV-466, 2003 U.S. Dist. LEXIS 20021, at \*12 (N.D.N.Y. Oct. 23, 2003) (“Customer lists are generally not considered confidential information.”).

<sup>104</sup> See *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 70 (2d Cir. 1999). The Second Circuit reasoned that “[s]ervices that are not simply of value to the employer, but that may also truly be said to be . . . unique” may fall under this category. *Id.*

<sup>105</sup> See *Columbia Ribbon & Carbon Mfg. Co. v. A-1-A Corp.*, 42 N.Y.2d 496, 499,

the analysis employed in Illinois, the second factor in New York recognizes that all or none of these areas may be protected depending on the extent to which the restrictive covenant places an undue hardship on the employee. For example, in *BDO Seidman v. Hirshberg*,<sup>106</sup> the New York Court of Appeals found that protecting existing client relationships of an accounting firm was a legitimate interest, whereas developing prospective clients within the accounting industry was not.<sup>107</sup> Lastly, under the third factor, the New York standard slightly deviates from that of Illinois by taking into account the public's interest in whether to enforce a particular restrictive covenant.<sup>108</sup> For example, New York courts will consider principles of good faith and fair dealing prior to enforcement.<sup>109</sup>

Virginia and Maryland courts promote standards similar to those used in New York, as the restraint is balanced between the positions of the employer, employee, and the public.<sup>110</sup> In *Grant*

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369 N.E.2d 4, 6, 398 N.Y.S.2d 1004, 1006 (1977). As long as the alleged confidential information is not "readily ascertainable from sources outside [the] business," it may be considered information that warrants protection. *Id.*

<sup>106</sup> 93 N.Y.2d 382, 712 N.E.2d 1220, 690 N.Y.S.2d 854 (1999).

<sup>107</sup> *Id.* at 392, 712 N.E.2d at 1225, 690 N.Y.S.2d at 859. "Extending the anti-competitive covenant to BDO's clients with whom a relationship with defendant did not develop through assignments to perform direct, substantive accounting services would" overburden the employee. *Id.*; cf. *Merrell Benco Agency, Inc. v. Safrin*, 231 A.D.2d 614, 615, 647 N.Y.S.2d 952, 953 (2d Dep't 1996). Confidential customer information may be considered a legitimate business interest, but it must be proven that the employee used the information to his or her benefit. *Id.*

<sup>108</sup> See *BDO Seidman*, 93 N.Y.2d at 394, 712 N.E.2d at 1226, 690 N.Y.S.2d at 860-61.

<sup>109</sup> *Id.* "[I]f 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 may be justified." *Id.*

<sup>110</sup> For Virginia's approach, see *Grant v. Carotek, Inc.*, 737 F.2d 410, 412 (4th Cir. 1984). The Fourth Circuit noted:

Virginia courts have applied a three-prong test:

(1) Is the restraint, from the standpoint of the employer, reasonable in the sense that it is no greater than is necessary to protect the employer in some legitimate business interests?; (2) From the standpoint of the employee, is the restraint reasonable in the sense that it is not unduly harsh and oppressive in curtailing his legitimate efforts to earn a livelihood?; (3) Is the restraint reasonable from the standpoint of a sound public policy?

*Id.*; see also *Alston Studios, Inc. v. Gress & Assocs.*, 492 F.2d 279, 282-83 (4th Cir. 1974). For the standard used in Maryland, see *Labor Ready, Inc. v. Abis*, 767 A.2d 936, 942 (Md. Ct. Spec. App. 2001). The test applied consisted of:

(1) whether restraint is necessary for the protection of the business or goodwill of the employer, (2) whether it imposes upon the employee any

*v. Carotek, Inc.*,<sup>111</sup> the Fourth Circuit applied Virginia law to determine that a restrictive covenant limiting an employee from competing for five years was too great an imposition on the employee and the public.<sup>112</sup> In *Labor Ready, Inc. v. Abis*,<sup>113</sup> the Court of Special Appeals of Maryland reviewed a non-compete that prohibited a former employee from “operat[ing]” for one year in the temporary-worker recruiting industry within a ten-mile radius from the employer’s office.<sup>114</sup> Although the non-compete covenant may seem reasonable at first glance, in light of the earlier discussion as to geographical limitations,<sup>115</sup> the court remanded the case in order to determine the meaning of “operate,” because if this term was interpreted broadly, it would be an extensive restriction and injurious in the public’s eyes.<sup>116</sup>

## II. THE EFFECT OF AT-WILL EMPLOYMENT ON RESTRICTIVE COVENANTS

### A. *Maw v. Advanced Clinical Communications, Inc.: Can an Employee Be Terminated for Refusing to Sign a Non-Compete Provision?*

In *Maw v. Advanced Clinical Communications, Inc.*,<sup>117</sup> the plaintiff, Ms. Karol Maw, was fired for refusing to sign a restrictive covenant containing non-compete, non-solicitation, and non-disclosure provisions that was presented to her three years after the commencement of employment.<sup>118</sup> Ms. Maw did

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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.

*Id.*

<sup>111</sup> 737 F.2d 410 (4th Cir. 1984).

<sup>112</sup> *Id.* at 411–12.

<sup>113</sup> 767 A.2d 936 (2001).

<sup>114</sup> *Id.* at 938–39.

<sup>115</sup> *See supra* Part I.C.1.

<sup>116</sup> *See Labor Ready, Inc.*, 767 A.2d at 944–47. The employer failed to specify what was included under the term “operate.” If interpreted broadly, and to the employer’s favor, the employee could not contact any potential customers within the defined radius. Rather than construing the language against the drafter concerning this ambiguous language, which is typical in contract disputes, the court postponed its decision to wait “[u]ntil the parameters of the non-compete provision [were] known . . .” *Id.* at 945–46.

<sup>117</sup> 846 A.2d 604 (N.J. 2004).

<sup>118</sup> *Maw v. Advanced Clinical Commc’ns, Inc.*, 820 A.2d 105, 110 (N.J. Super. Ct.

not object to the disclosure and solicitation portions, but disputed the non-compete provision because she felt it would restrict her from future employment opportunities.<sup>119</sup> Similar to other states,<sup>120</sup> New Jersey courts weigh the interests of the employee versus the employer with due consideration for the public's "concern in fostering competition, creativity, and ingenuity."<sup>121</sup> The court found for the employer, reasoning that Ms. Maw could dispute the non-competition provision when the employer attempted to enforce it.<sup>122</sup>

In *Maw*, essentially, the court decided that an employee's one channel for disputing a restrictive covenant was in response to the employer's attempt at enforcement through legal means.<sup>123</sup> Although the court reasoned that the burden of enforcement was on the employer, this Note asserts that the opinion failed to recognize that the employee would be placed in an unfavorable economic and legal position.<sup>124</sup> Although the *Maw* decision is persuasive, not all states agree with its line of reasoning. For example, contrary to *Maw*, California case law has suggested that an employee cannot be fired for the failure to sign a restrictive covenant because the employee does not have equal bargaining power for negotiation when faced with an impending termination.<sup>125</sup> Regardless, the *Maw* decision brought a "sigh of relief" to employers and may have far-reaching implications in encouraging the use of restrictive covenants.<sup>126</sup>

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App. Div. 2003), *rev'd*, 846 A.2d 604, 607 (N.J. 2004).

<sup>119</sup> *Id.* at 111.

<sup>120</sup> *See supra* notes 101, 109–10 and accompanying text.

<sup>121</sup> *Maw*, 846 A.2d at 609; *see also* *Ingersoll-Rand Co. v. Ciavatta*, 542 A.2d 879, 887–88 (N.J. 1988); *Solari Indus. Inc. v. Malady*, 264 A.2d 53, 56 (N.J. 1970).

<sup>122</sup> *See Maw*, 846 A.2d at 609.

<sup>123</sup> *See id.*

<sup>124</sup> From an economic position, an employee will probably possess inferior legal resources as compared to the employer in preparing for litigation. Furthermore, rather than negotiating with the employer initially over the terms of the non-compete clause, the employee will have to hope that the employer does not seek enforcement, thereby placing herself in an adverse legal position.

<sup>125</sup> *See D'Sa v. Playhut, Inc.*, 102 Cal. Rptr. 2d 495, 501 (Ct. App. 2000) (objecting to "the concept that a worker, compelled by economic necessity to secure employment, can be thus coerced into signing [a restrictive covenant] in the uninformed hope the agreement will not be enforced by the courts"); *see also* *Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp. 2d 1089, 1097 (C.D. Cal. 1999).

<sup>126</sup> *See Anderson & Horwitz supra* note 15 (commenting that "[i]t is clear that *Maw* reaffirms the continued viability of reasonable restrictive covenants"); Thomas A. Muccifori, *No Maw Uncertainty*, 176 N.J. L.J. 811 (2004) (emphasizing that "the decision will not only restore certainty to employers who seek to legitimately protect

*B. Do Restrictive Covenants Persevere When the Employee Was Fired?*

The termination of an employee bound by a restrictive covenant will probably be considered in determining enforceability. In situations where an employer is properly exercising at-will termination, state courts apply one of three approaches.<sup>127</sup> The first method, employed solely by New York, considers enforcement where the employee was terminated for cause<sup>128</sup> but invalidates covenants applied against employees terminated without cause.<sup>129</sup> The second approach, followed in a majority of states, places a heavier burden of persuasion on the employer for enforcement after termination than would be required if the employee had instead resigned.<sup>130</sup> The last approach, utilized only by Florida, refuses to factor the involuntary termination into its review of the restrictive covenant's enforceability.<sup>131</sup>

*C. Is the Expectation of Continued Employment Adequate Consideration?*

One of the basic arguments supporting the enforcement of restrictive covenants is that the employee receives sufficient consideration in exchange for the promise not to compete, solicit

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business interests through the use of restrictive covenants but will also reassure their counsel who draft, negotiate and litigate such covenants”).

<sup>127</sup> See Kenneth J. Vanko, “You’re Fired! And Don’t Forget Your Non-Compete. . .”: *The Enforceability of Restrictive Covenants in Involuntary Discharge Cases*, 1 DEPAUL BUS. & COM. L.J. 1, 9 (2002); see also Stone, *supra* note 1, at 739–43 (analyzing the various approaches and rationales courts have taken towards non-compete agreements in the at-will employment context).

<sup>128</sup> See Vanko, *supra* note 127, at 10; see also Gismondi, Paglia, Sherling, M.D., P.C. v. Franco, 104 F. Supp. 2d 223, 232–33, (S.D.N.Y. 2000) (analyzing a restrictive covenant where the employee was terminated for misappropriation of the employer’s funds).

<sup>129</sup> See *Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 48 N.Y.2d 84, 89, 397 N.E.2d 358, 361, 421 N.Y.S.2d 847, 849 (1979) (finding the covenant invalid *per se* due to a termination without cause).

<sup>130</sup> See Vanko, *supra* note 127, at 9, 11. Under this approach, the court presumes that the restrictive covenant is invalid, unless the employer can demonstrate that enforcement is a necessary protection. See *id.*; see also *Safety-Kleen Sys., Inc. v. Hennkens*, 301 F.3d 931, 934, 936–937 (8th Cir. 2002) (holding that employee-customer contacts are a protectable interest warranting enforcement of a covenant not to compete).

<sup>131</sup> See Vanko, *supra* note 127, at 9 (indicating that the final approach is “decidedly pro-employer and holds that a court cannot consider an involuntary termination”).

former clients or employees, or disclose information.<sup>132</sup> The main debate in this area is whether the promise of continued employment constitutes sufficient consideration.<sup>133</sup> Unfortunately, neither the *Restatement of Contracts*<sup>134</sup> nor state statutes provide much guidance to help clarify this issue.<sup>135</sup> Furthermore, unlike other variables surrounding enforcement where state courts may support one another, this is an area where courts disagree.<sup>136</sup> As this determination is left to the court's discretion, an employer looking to relieve uncertainty should offer separate consideration in exchange for the employee's agreement to enter into a restrictive covenant.

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<sup>132</sup> See Blake, *supra* note 18, at 629–31 (discussing the importance of consideration in the “early cases”). Consideration was evident in *Mitchel v. Reynolds*, discussed above, where the baker leased his business and agreed not to compete with the lessee. *Id.* at 629.

<sup>133</sup> See Yates, *supra* note 2, at 1124 (discussing “whether the consideration given by the employer for a noncompetition covenant is illusory because of the employer's unrestricted right to terminate employment unilaterally at any time even without cause”).

<sup>134</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 188 (1981) (failing to provide any assistance on whether consideration separate from employment is necessary).

<sup>135</sup> Of the twenty state statutes that govern restrictive covenant enforcement, only two mention consideration. In Oregon, a non-compete that is entered into after the start of employment will not be enforced, unless the employer provides additional consideration. OR. REV. STAT. § 653.295(1)(b) (2003). In Georgia, consideration is mentioned in two areas. First, there must be consideration in the sale of a controlling interest. GA. CODE ANN. § 13-8-2.1(b)(1)(D), (G) (2001). Second, where a portion of the restraint needs to be clarified, no additional consideration is necessary. *Id.* § 13-8-2.1(f)(3).

<sup>136</sup> Some states view continued employment as sufficient consideration. See, e.g., *Affiliated Paper Cos. v. Hughes*, 667 F. Supp. 1436, 1448–49 (N.D. Ala. 1987) (“[T]his Court is thoroughly persuaded that . . . [the employment contract,] . . . terminable at the will of either party, does not . . . require a determination . . . that the noncompetition clause . . . was unreasonable.”); *McRand, Inc. v. Van Beelen*, 486 N.E.2d 1306, 1313–14 (Ill. App. Ct. 1985); *Computer Sales Int'l, Inc. v. Collins*, 723 S.W.2d 450, 452 (Mo. Ct. App. 1986); *Hogan v. Bergen Brunswick Corp.*, 378 A.2d 1164, 1167 (N.J. Super. Ct. App. Div. 1977). Other states, however, require additional consideration. See, e.g., *Freeman v. Duluth Clinic, Ltd.*, 334 N.W.2d 626, 630 (Minn. 1983); *Kadis v. Britt*, 29 S.E.2d 543, 548–49 (N.C. 1944); *McCombs v. McClelland*, 354 P.2d 311, 315 (Or. 1960); *George W. Kistler, Inc. v. O'Brien*, 347 A.2d 311, 316 (Pa. 1975).

### III. AREAS WHERE RESTRICTIVE COVENANTS HAVE AN INCREASED CHANCE OF ENFORCEMENT

#### A. "Legitimate" Trade Secrets

Employers usually invoke the inevitable disclosure doctrine to protect trade secrets and allege that an employee has violated a non-disclosure agreement simply by accepting new employment.<sup>137</sup> As one esteemed scholar indicated, it is understandable that employers wish to safeguard their interests in such a technologically advanced workplace.<sup>138</sup> But what constitutes a trade secret? As discussed earlier, both legislatures and courts have struggled in their attempt to determine what falls under this label.<sup>139</sup>

The *Restatement of Torts* points out that trade secrets "may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives [a person] an opportunity to obtain an advantage over competitors who do not know or use it;"<sup>140</sup> this model was later approved as a national standard.<sup>141</sup> Unfortunately, the determination of what falls under this definition is complicated because of the perpetually changing nature of the business world.<sup>142</sup> Consequently, courts are left to balance, on a case-by case basis, the extent to which competitors and the general public are familiar with the information against the irreparable harm to the

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<sup>137</sup> See *supra* note 5 and accompanying text (discussing the theory and effect of the inevitable disclosure doctrine).

<sup>138</sup> See Gregory, *supra* note 7, at 27. Businesses have good reason to feel vulnerable, as confidential information can be easily transferred out of the workplace. See *id.* (discussing the effect of an increase in "high-tech, computer-based knowledge workers" on company security given the fact that so much company information can "be placed on a single computer disc").

<sup>139</sup> See *supra* Parts I.A, I.C.2 (demonstrating the debate as to the requirements governing restrictive-covenant law).

<sup>140</sup> RESTATEMENT (FIRST) OF TORTS § 757 cmt. b (1939).

<sup>141</sup> See Godfrey, *supra* note 11, at 163 (indicating that the *Restatement's* definition served as a model for state trade secrets law until its adoption by the National Conference of Commissioners on Uniform State Law under the Uniform Trade Secrets Act); see also Brandy L. Treadway, *An Overview of Individual States' Application of Inevitable Disclosure: Concrete Doctrine or Equitable Tool?*, 55 SMU L. REV. 621, 626 (2002) (stating that the "[Uniform Trade Secrets Act] was designed to clarify definitions, set statutes of limitations and codify case law for remedies").

<sup>142</sup> See Godfrey, *supra* note 11, at 163 n.15 (indicating that the *Restatement* provides a non-exhaustive record of potential trade secrets due to the difficulty in scripting a proper definition).

company were the information disclosed.<sup>143</sup> Under this approach, the trade secret must be genuinely unique;<sup>144</sup> thus, information that is considered readily available to the public will not be protected.<sup>145</sup>

### *B. Nature of the Contractual Relationship*

There are two additional conditions that support an argument for enforcement. The first circumstance, where a seller, lessor, or departing partner signs a restrictive covenant, induces minimal debate concerning the document's enforcement for two reasons: (1) statutory exceptions allow for enforcement<sup>146</sup> and (2) courts are willing to favor enforcement in this area.<sup>147</sup>

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<sup>143</sup> For example, a recent Second Circuit opinion weighed the following factors to ascertain whether trade secrets existed:

- (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 business to guard the secrecy of the information;
- (4) the value of the information to the business and its competitors;
- (5) the amount of effort or money expended by the business in developing the information; and
- (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

Johnson Controls, Inc. v. A.P.T. Critical Sys., Inc., 323 F. Supp. 2d 525, 537 (S.D.N.Y. 2004).

<sup>144</sup> See *SI Handling Sys., Inc. v. Heisley*, 753 F.2d 1244, 1263 (3d Cir. 1985) (finding the methods concerning the robotic system at issue to be trade secrets as the product was the first of its kind).

<sup>145</sup> See *Colonize.com, Inc. v. Perlow*, No. 03-CV-466, 2003 U.S. Dist. LEXIS 20021, at \*12-13 (N.D.N.Y. Oct. 23, 2003) (finding that customer information is not confidential when it can be "acquired by anyone desiring it"); *Chiswick, Inc. v. Conostas*, No. 2004-00311, 2004 Mass. Super. LEXIS 272, at \*8-9 (Mass. Super. Ct. June 17, 2004) (commenting that information was not confidential "where the employer openly shares information among its employees"); *JAD Corp. of Am. v. Lewis*, 305 A.D.2d 545, 546, 759 N.Y.S.2d 388, 388 (2d Dep't 2003) (concluding "that the information the plaintiff sought to protect [was] readily available from publicly-available sources"); see also *Gregory*, *supra* note 7, at 34 (claiming "[a]bsent evidence of actual misappropriation by an employee, restrictive covenants should be enforced in only the rarest of cases"); *Stone*, *supra* note 1, at 763 (advocating that "courts should adopt a narrow definition of trade secrets, limit enforcement of noncompete covenants to the protection of trade secrets narrowly defined, [and] reject the doctrine of inevitable disclosure").

<sup>146</sup> See, e.g., CAL. BUS. & PROF. CODE § 16601-16602 (Deering 1992 & Supp. 2005); MONT. CODE ANN. § 28-2-703 (2003); N.D. CENT. CODE § 9-08-06 (2002); OKLA. STAT. ANN. tit. 15, § 218-219 (West 2002).

<sup>147</sup> See, e.g., *Group Concepts, Inc. v. Barberino*, No. CV030286221, 2004 Conn. Super. LEXIS 1036, at \*17-18 (Conn. Super. Ct. Apr. 16, 2004) (awarding a preliminary injunction to the purchasers of a real estate company to restrict the former owner from competing); *Boulanger v. Dunkin' Donuts Inc.*, 815 N.E.2d 572, 578 (Mass. 2004) (finding a non-compete limiting a donut-chain franchisee

The second argument for enforcement is where the employee's learned skills are so specialized that the employer will inevitably suffer severe harm when the employee leaves.<sup>148</sup> The determination of what constitutes a special service hinges on the employment relationship—specifically, the extent to which the company depends on the employee's talents and the ability of the employer to staff the position after the employee leaves.<sup>149</sup> Although restrictive covenants in these areas have an increased chance of enforceability, it is important to use reasonable temporal and geographic restrictions in order to avoid judgments that modify or invalidate the agreements.<sup>150</sup>

#### CONCLUSION

With such a vast amount of state law to digest in comprehending the limits of restrictive covenants, it is understandable that employers and employees may become disillusioned in deciphering their respective rights. Unfortunately, there probably is not much else legislatures or judges can propose to clarify this issue. Furthermore, it is unlikely that the United States Supreme Court will supply a common standard because each state has its own justifications for enforcing or invalidating restrictive covenants. Laws governing restrictive covenants have originated from state policy, thus leading to inconsistencies in what states feel is crucial in determining enforcement. Additionally, the concept of legitimate business interests is a moving target as a result of an ever-changing technological world.

A possible improvement would be for state standards to place more emphasis on the education of both parties. In order for an employer to elicit favor from the courts, restrictive covenants have to be tailored to the specific activity, possess reasonable limits, and protect only those interests that are indeed legitimate and undisclosed. Anything more restrictive is not worth an attorney's fees for drafting, as boilerplate restrictive

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enforceable).

<sup>148</sup> See *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 70 (2d Cir. 1999) (indicating that services that are "special, unique or extraordinary" might influence a court to enforce a covenant restricting these activities, but only if the employer can show injury).

<sup>149</sup> *Id.*

<sup>150</sup> See *supra* Part I.C.1 (discussing the role of geographic and temporal limitations on the enforcement of restrictive covenants).

covenants are not looked upon favorably.<sup>151</sup>

Additionally, it is strongly recommended that employees seek legal counsel prior to signing restrictive covenants. In light of recent case law, it may not be a prudent idea to refuse to sign, but rather to recognize fully the ramifications of the covenant and evaluate whether the position is worth relinquishing certain future opportunities in return for imminent employment. Furthermore, after receiving an offer and prior to exhausting other employment opportunities, it is advised that an employee inquire about the employer's policy concerning restrictive covenants as a condition of initial employment or later in the employment relationship. This may alleviate some of the inequity in the respective parties' bargaining positions when an employee is confronted with a restrictive covenant at either the commencement of or during employment. Although these are some of the many suggestions for improvement, employers and employees should heed the advice of outside counsel prior to forming a contractual relationship because our court dockets cannot endure much more litigation in this area.<sup>152</sup>

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<sup>151</sup> See Gregory, *supra* note 7, at 27–28 (opining that courts “have not been well-disposed to boilerplate covenants”).

<sup>152</sup> See Stone, *supra* note 1, at 723 (citing that these disputes are becoming one of the most “frequently litigated issues in the employment law field”).