BARNES & THORNBURG LLP

NEWSLETTERS

Re-Consideration?: State Courts Looking Hard At Contractual Threshold For Noncompetes

December 11, 2014 | Columbus | Atlanta | Chicago | Delaware | Elkhart | Fort Wayne | Grand Rapids | Indianapolis | Los Angeles | Minneapolis | South Bend

Note: This article appears in the December 2014 edition of Barnes & Thornburg LLP's Commercial Litigation Update e-newsletter.

Covenants not to compete can be a critical tool for some businesses' ability to protect their investments in intellectual property and key business relationships. While lesser tools like confidentiality agreements and agreements not to solicit particular customers and/or employees can also accomplish these goals, for many employers the ability to prevent an employee from working competitively to the extent allowed by applicable state law is a uniquely powerful tool. However, recent court decisions in several states may signal a trend that could make enforcing these agreements more challenging for businesses that do not carefully map out their enforcement strategy in advance.

Perhaps the overriding issue in drafting and enforcing noncompetes is that state laws on interpretation and enforcement of the agreements vary markedly. Further, courts do not always respect the parties' contractual choice of law and/or forum in the agreements. Therefore, in preparing the agreements, companies need to consider the possibility that their agreements will be interpreted under the laws of other states in which they do business.

State laws vary primarily with respect to two key questions. First, to what extent will a court modify an agreement it finds to be overbroad in order to "make it enforceable"? Second, and the focus of this article, what consideration is required in order for the court to consider the noncompete to be a valid contract? Courts generally do not scrutinize the adequacy of consideration in contract litigation. When it comes to noncompetes, though, there is the overlay of a public policy disfavoring restricting employees' ability to work, so some states' courts do examine consideration more carefully.

Courts generally look at consideration for noncompetes in one of three ways. The most pro-enforcement position is that mere continuing employment is sufficient consideration for a noncompete. In other words, a company can tell a long term employee who did not previously have a noncompete that, if she wishes to continue employment, she has to sign a noncompete. If she does, it is enforceable. This is the law in Ohio, for example, under the Ohio Supreme Court's decision in *Lake Land Employment Group of Akron, LLC v. Columber*, 101 Ohio St. 3d 242, 804 N.E.2d 27 (2004).

Many states provide that mere continuing employment is not sufficient consideration for a noncompete, but that at will employment is. In others words, if a noncompete is entered into when the employment relationship begins, it is enforceable. (Under such a rule, it is of course critical for

RELATED PEOPLE

William A. Nolan
Partner
Columbus

P 614-628-1401
F 614-628-1433
bill.nolan@btlaw.com

RELATED PRACTICE AREAS

Commercial Litigation
Litigation

businesses to have practices in place to ensure the noncompetes are in fact signed before employment begins.) Finally, some courts require some consideration beyond the commencement of an employment relationship in order to support a noncompete.

Most notably in this regard, the Kentucky Supreme Court earlier this year held in *Charles T. Creech, Inc. v. Brown*, 433 S.W.3d 345 (Ky. 2014) that continuing employment is not sufficient consideration for a noncompete. Mr. Brown was an 18-year employee of Creech, which provided straw and hay to farmers throughout Kentucky, at the time he was required to sign a noncompete in 2006. He resigned in 2008 and went to work for a competitor, and Creech sued to enforce his noncompete.

The Kentucky Supreme Court said that Brown's continuing employment was not sufficient consideration for a noncompete and the restrictions were therefore unenforceable. Looking at seemingly contrary past Kentucky cases, the court said in those cases there was some other benefit to the employee at the time the noncompete was entered into. In other words, there was something greater than continued employment. The decision does not seem to render unenforceable noncompetes entered into at the time of at will employment.

The law in Illinois, however, may be even less conducive to enforcement after the Illinois Supreme Court declined to review a state appeals court's decision in *Fifield v. Premier Dealer Services, Inc*., 373 Ill. Dec. 379, 993 N.E. 2d 938 (Ill. App. 2013). Fifield was laid off when the division in which he worked was acquired by another company. The purchasing company subsequently offered Fifield a job, conditioned on his signing a noncompete, which he did. After just three months on the job, Fifield resigned and went to work for a competitor. The court of appeals declined to enforce Fifield's noncompete, saying that three months of employment was not sufficient to support a noncompete. The court suggested that two years of employment would normally be required.

Finally, the Wisconsin Supreme Court is presently considering whether to adopt a similar rule in *Runzheimer Int'l, Ltd. v. Friedlen*. There, Runzheimer required Friedlen to sign a noncompete after nearly 20 years of at will employment. Two years later, Runzheimer fired Friedlen, who went to work for a competitor. The lower court found his noncompete was unenforceable due to lack of consideration. The Court heard oral argument in October 2014 and a decision is expected in the first half of 2015.

With three state Supreme Courts weighing in a two-year period, this area is definitely in flux, seemingly with a trend towards a higher threshold for what constitutes consideration to support a noncompete. What should businesses do?

In the enforcement and litigation context, employers must be mindful of different state laws that might apply and factor that into their strategy before taking action. This analysis should begin even before the first letter is sent, because an employee or competitor receiving that letter may respond by running to court in a friendlier forum, seeking a declaratory judgment that the agreement is not enforceable, rather than waiting to be sued in a state of the former employer's choosing. So the state law analysis should begin at the very first opportunity.

From a litigation planning and avoidance stage, businesses should work

with counsel to ensure that their agreements have the strongest possible choice of law and choice of forum clauses. They should also ensure that the agreements reflect any possible consideration – training, promotions, and bonuses are examples of things already provided that might help bolster a noncompete.

Beyond that, companies should not approach noncompetes on an ad hoc basis. Rather, they should build a noncompete strategy systematically, considering the various states' laws they may encounter in enforcing them and structuring consideration accordingly. There is too much at stake not to.

William A. Nolan is a member of the Firm's Commercial Litigation Practice Group, and Managing Partner of the Firm's Columbus, Ohio office. Bill can be reached by telephone at (614) 628-1401 or by email at bill.nolan@btlaw.com.