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NEWSLETTERS

The Law Of Covenants Not To Compete In 6 Easy Steps (And A New Case For Each)

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Case law and statutory developments about noncompete agreements are often in our news feeds. Yet the basic principles do not change materially from year to year. Rather, the law in particular states develops on one or more key points and, as discussed further below, state law is key. Businesses with an interest in noncompetes need to be aware of developments outside their state lines. Here are the six pieces of noncompete law and a new case illustrating each.

1. Noncompetes will be enforced to the extent they protect a "legitimate business interest" (or words to that effect).

White v. Mederi Caretenders Visiting Services of Southeast Florida, LLC, Case No. SC16-28 (Fla. Sup. Ct., Sep. 14, 2017).

States that enforce noncompetes to some extent (almost all states) will protect only some form of what courts find to be a legitimate business interest. While this is a core principle of noncompetes, arguably it is an area where there is more smoke than fire. In other words, while there are plenty of court decisions setting forth various factors to be considered, at its core these legitimate business interest tests boil down to a highly fact-specific fairness inquiry: Has the employer made some particular investment in what it is trying to protect that would make it unfair for the employee to utilize information, relationships or other valuable resources he or she acquired while employed by a former employer?

White concerns the interpretation of Florida Statute 542.335, which actually enumerates (non-exclusively) interests that can be protected by noncompete agreements under Florida law. (It is not uncommon, but not the norm for states to have a noncompete statute). The statute does not set forth referral sources as a protectable interest, but in White the Florida Supreme Court unanimously held that referral sources are protectable interests.

The case involved two former marketing representatives who cultivate patient referrals for home health care services. Home health care companies, the court wrote, do not directly solicit patients, but rely on referrals from doctors. The court saw the business value in the investment in referral sources, but did emphasize that the question would be fact-specific (of course) in future cases.

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2. Forum selection clauses are usually enforceable and, given the variability in state laws, that's a big deal.

Stone Surgical, LLC v. Stryker Corp., Case No. 16-1434 (6th Cir., May 24, 2017).

When I talk about the variability in states' laws, employers sometimes say, "Well, we have a <insert employer's noncompete-friendly home state here> choice of law clause." That's nice, but most states' choice of law rule is that courts will enforce the parties' choice of law, except where doing so would offend the public policy of the forum state. Since the application of different noncompete rules is often case-determinative, a forum state might very well choose not to enforce a clause choosing another state's laws.

Forum/venue clauses, however, are enforced by most courts. In *Stone Surgical*, a sales rep who worked in Louisiana for Stryker for a number of years was subject to a noncompete with a Michigan choice of law and forum clause. After 12 years, the sales rep left to take a position with a competitor, servicing customers he worked with while representing Stryker. Stryker filed suit against the sales rep in Michigan and obtained a jury verdict.

The sales rep appealed, challenging the enforceability of the choice of forum and law clauses. The federal appellate court barely discussed the choice of forum clause, noting in this case that Michigan law, as is usual, favors such clauses.

3. Big state-by-state variable #1: What will the court do if it finds a noncompete to be overly broad?

Golden Road Motor Inn v. Islam, 132 Nev. Op. 49 (Jul. 17, 2016).

In *Golden Road Motor Inn, Inc. v. Islam,* the Nevada Supreme Court found that a one-year, 150-mile noncompete imposed on a casino host was overly broad because it would have prohibited the host – in effect a customer relations representative for the casino – from being employed even as a custodian.

The key question then becomes: What, if anything, will the court do to the agreement, i.e. will it narrow the restriction to make it enforceable? Courts take three approaches to this:

- The most enforcement-friendly approach is to simply rewrite the provision to provide whatever restriction the court finds reasonable. In Golden Road, the court, for example, could have applied the noncompete only to host positions and/or reduce the 150-mile radius to a radius it found more reasonable.

- The court could "blue pencil" the document, which technically means it will not rewrite the agreement, but it will strike offending language, and do no more.

- Some courts will not modify the agreement at all. If it is too broad,

the employer simply has no restriction at all, which is the least enforcement-friendly approach.

The Nevada Supreme Court chose door No. 3 and held that it would not modify the agreement. Therefore, since it found the noncompete too broad, there was no restriction at all.

4. Big state-by-state variable #2: What consideration is necessary to support a noncompete?

American Air Filter Co., Inc. v. Price, 2017 NCBC 54 (N. Car. Bus. Ct., June 26, 2017).

In many states, the right to come to work tomorrow, even in an at will position, is sufficient consideration. In other words, an employer can demand that a long-time employee sign a noncompete for the first time years into employment, and that noncompete will be enforceable. In other states, more is required, at least if the agreement is entered into after the beginning of employment.

The latest case of note on this point comes from the North Carolina Business Court in *American Air Filter*. In this case, the employee entered into a noncompete in 2006, 17 years after he began working for the plaintiff employer seeking to enforce the agreement. The agreement was one that automatically renewed from year to year. In this case, the court found that, while there actually was sufficient consideration when the agreement was signed, there was no consideration when the agreement renewed from year to year.

5. California is very different, but former employees are not wholly unrestricted.

Fidelity Brokerage Services, LLC v. Brett Rocine, Case No. 17-cv-4993-PJH (N.D. Cal., Sep. 7, 2017).

California in effect prohibits noncompete agreements other than in very narrow circumstances; indeed, the state even has a statute saying as much (Cal. Bus. & Professions Code Section 16600) and, effective in 2017, a statute prohibiting employers from making employees sign an agreement to another state's law or venue a condition of employment (Cal. Labor Code 925).

Rocine indicates one avenue for California employers seeking to restrict former employees. The employee signed a nondisclosure agreement that prohibited him – for one year after his separation from employment – from using any confidential company information, including information relating to customers, for soliciting a company client to move its business away from the employer.

After working with Fidelity Brokerage and calling on clients, the employee abruptly announced his departure. When Fidelity Brokerage discovered the former employee had gone to work for a direct competitor and was calling on and soliciting the very same customer, the company sent a cease and desist letter, reminding him of his promise not to use confidential customer or account information.

Fidelity Brokerage sued for breach of contract and misappropriation of trade secrets. The court issued a temporary restraining order, concluding that the employee must have put together a list of customers from memory after his departure and then looked up their contact information. The court rejected the employee's counter-arguments that the contact information was publicly available, reasoning that he would not have known which customer names to look up had he first not obtained those names during his employment – which was confidential and thus protected under the parties' contract.

6. The new employer needs to be mindful of a tortious interference claim.

Acclaim Sys. v. Infosys, Ltd., 2017 U.S. App. LEXIS 2325 (3rd Cir. 2017).

Noncompete litigation has an additional piece – the common tortious interference counterclaim against the former employer seeking to enforce its noncompete. As a practical matter, it seems that these counterclaims are more of a negotiating tool, not frequently resulting in actual liability on the part of the former employer, but at least warranting a careful approach by the enforcing employer.

In *Acclaim*, Infosys took over a project Acclaim had been working on and promptly hired several individuals who had been working for Acclaim on the project. The court reported that Infosys had actually asked each new hire if he or she was subject to a noncompete and was told "no." The court rejected the plaintiff's argument that Infosys should have presumed there were noncompetes because they are common in the industry.

While this case seems straightforward, it illustrates a frequent dynamic in a dispute involving former employees – including the wisdom for all employers of inquiring in writing whether new employees have contractual restrictions on their ability to become employed. As Acclaim illustrates, it is hard to tortiously interfere with a contract of which the company is unaware.

Conclusion

These basic points of noncompete law generally do not change. However, the fact that new cases frequently arise for almost each one of these points illustrates that restrictive covenant litigation is a very active area. The basic concepts are pretty straightforward, but keeping up with the finer points and applying them in drafting and litigation is not always!

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