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Developments and Trends in Unfair Competition Law

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Please Note…

Unfair competition law tends to be highly state-specific. The analysis herein is intended to be for guidance purposes only. Companies should consult with counsel and understand local laws before adopting or changing policies.

Legislative and Legal Update

- Developments in states have been consistent with the prevailing view that unfair competition law is peculiarly state-specific.
- Overview of legal changes in selected states:
  - Texas
  - Georgia
  - Massachusetts
  - Illinois
  - Colorado
  - California
  - South Carolina
  - Wisconsin

Texas

- Texas continues its reform of noncompete laws through its court system with the recent decision, *Marsh v. Cook*, Tex. Sup. Ct. J. 1234, 2011 WL 2517019 (Tex. June 24, 2011).
- Court eliminated Texas's distinctive requirement that the consideration given for a noncompete agreement must relate to the legitimate interest the employer sought to protect.
- Practical effect is that noncompete agreements should be significantly easier to enforce in Texas.

Texas (cont'd)

- Other recent Texas changes:
  - *Alex Sheshunoff Management Services, L.P. v. Johnson*, 2009 S.W.3d 644 (Tex. 2006)—rejects the requirement of simultaneous exchange of consideration under Texas law
  - *Mann Frankfort Stein & Lipp Advisors v. Fielding*, 289 S.W.2d 844 (Tex. 2009)—recognizes implied promise as sufficient to support noncompete agreement

Georgia

- Georgia voters approved new frameworks for noncompete agreements via constitutional amendment

Georgia (cont'd)

New Law:

- Permits Georgia courts to "blue pencil" otherwise overly broad noncompete agreements
- Provides for a presumptive reasonable time restriction of two years
- Provides that an agreement need not specify the precise location in which competition is to be enjoined
- Applies to sales employees, exempt executive and professional employees, and broadly defined "key employees"

Georgia (cont'd)

- *Cox v. Altus Healthcare and Hospice, Inc.*, 2011 WL 1983888 (Ga. App. Jan. 24, 2011), first appellate decision to cite to Georgia's new law. Decision confirmed that the Court of Appeals will apply pre-existing caselaw to decide enforceability of restrictive covenants entered into prior to the new law being enacted.
  - "The statute shall not apply in actions determining the enforceability of restrictive covenants entered into before its ratification [on November 2, 2010]."

Massachusetts

- Proposed Massachusetts legislation could alter landscape for noncompete agreements
- Legislative hearings were held on September 15, 2011
- Protracted legislative wrangling has been contentious; at the 9-15-11 hearings, a representative from the Governor's administration warned that if middle ground could not be reached, it would consider whether the "outright elimination of enforceability altogether is the best course of action for the Massachusetts economy"

Massachusetts (cont'd)

- The proposed legislation includes the following highlights:
  - Minimum compensation requirement—noncompete agreements would be valid only for employees whose average gross income is $75,000 or more;
  - Advance notice—noncompete agreement must be provided at least seven days before employment commences;
  - "Mid-employment agreements" entered into after employment commences must be supported by new "fair and reasonable" consideration beyond continued employ;

Massachusetts (cont'd)

- Durational limits—Duration must be limited to one year post-employment unless there is a "garden leave" clause;
- Payment of employee's legal fees in certain circumstances to deter overzealous prosecution; and
- Inevitable disclosure is expressly rejected as a protectable interest of the employer.

Illinois

- Illinois appellate court rejected "legitimate business interest" test, making it potentially easier for employers to enforce restrictive covenants in *Sunbelt Rentals, Inc. v. Ehlers* (4 Dist. 2009)
- Under legitimate business interest test, employer must show either:
  - Customer's relationship with the employer is "near permanent"; or
  - The employee gained genuinely confidential information through employment and then attempted to use it for his or her benefit.

Illinois (cont'd)

- The *Ehlers* court abandoned that test and held that enforcement should be determined simply based on reasonableness of the restrictions in the noncompete agreement
- A bill has been introduced in the Illinois Legislature that, if adopted, would reinstitute the "legitimate business interests" requirement that had been rejected by the court in *Ehlers*

Illinois (cont'd)

- If passed, the Act would limit noncompetes to "key employees" who have:
  - significant involvement in firm management,
  - direct and substantial contact with firm customers,
  - knowledge of trade secrets or important proprietary information,
  - unique skills that have given the employee significant notoriety as a representative of the firm, OR
  - a salary in the top 5% of the firm's employees.

Colorado

- *Lucht's Concrete Pumping, Inc. v. Horner*, Case No. 09SC627 (Supreme Court of Colorado, May 31, 2011) (en banc) reversed 2001 Appellate ruling that had held that continued employment was insufficient consideration.
- Colorado Supreme Court held that additional consideration need not be provided to an existing employee, provided the company does not intend to immediately fire the employee after obtaining a noncompete agreement and does not in fact do so.

California

- Noncompete agreements were long assumed to be largely unenforceable in California since 2008 *Edwards v. Arthur Andersen* decision; however, *Edwards* left open the possibility that noncompete agreements could be used to protect trade secrets.
- *Richmond Technologies Inc. v. Aumtech Business Solutions*, No. 11cv2460, 2011 WL 2607158 (N.D. Cal. July 1, 2011), enforced a noncompete agreement and held that "former employees may not misappropriate the former employer's trade secrets to unfairly compete with the former employer."

California (cont'd)

- *Richmond Technologies* decision indicates that even jurisdictions that were typically hostile to noncompete restrictions will consider enforcing them under egregious circumstances such as deceptive behavior by former employees.
- California Business & Professions Code Section 16600 broadly prohibits "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind."

South Carolina

- South Carolina Supreme Court expressly rejects “blue penciling or rewriting territorial restrictions” in *Poynter Investment, Inc. v. Century Builders*, 387 S.C. 583, 597 (2010).
- Reversed lower court, which had removed language deemed too broad and replaced with its own, narrower terms.
- Commentators have noted that the South Carolina Supreme Court erroneously referred to the lower court’s reformation as “blue penciling” in the *Poynter* decision.

Wisconsin

- Traditionally has been an “all or nothing” state, permitting only a “red pencil” approach to the contract.
- In *Star Direct, Inc. v. Dal Pra*, 767 N.W.2d 898 (Wis. 2009) the Wisconsin Supreme Court significantly altered the law there by holding that reasonable covenants restricting competition are enforceable even when contained in contracts with other unenforceable covenants, as long as the covenants are divisible.

Wisconsin (cont'd)

- The *Dal Pra* decision represents significant and favorable change in the law for employers as courts there can now strike unenforceable clauses and leave intact the remainder of the agreement.

TRENDS

- Waiver (Estoppel)
- Bimbo – Inevitable Disclosure
- Geographic Restrictions

Employer Acts Constituting Waiver

- A variety of acts may constitute a waiver of the right to enforce a noncompete agreement, such as statements made indicating waiver of certain provisions:
  - *Everett J. Prescott, Inc. v. Ross*, 390 F. Supp. 2d 44 (D. Me. 2005) (statement in open court that plaintiff's geographic concern was only within 100 miles of two distribution centers waived enforcement of noncompete agreement except within 100 miles of the two distribution centers); *Durham Life Ins. Co. v. Evans*, 166 F.3d 139, 159 (3d Cir. 1999) (stating that where vice president told employee that noncompete agreement had been abrogated, employee was entitled to rely on it).

Waiver

- Waiver "involves the intentional relinquishment of a known right, or such conduct as warrants an inference of the relinquishment of such right, and may result from an express agreement or be inferred from circumstances." *Simko, Inc. v. Graymar Co.*, 55 Md. App. 561, 464 A.2d 1104, 1109 (1983) (explaining waiver is issue for fact-finder and upholding trial court's finding that employer had not waived its right to enforce noncompete agreement).

Employer Acts Constituting Waiver

- Failure to object to employee's announcement or actions. *Becker Holding Corp. v. Becker*, 78 F.3d 514, 516 (11 Cir. 1996) (finding waiver where employer failed to object to employee's announcement of competing activity); *Schmid v. Clarke, Inc.*, 245 Neb. 856 (1994) (finding waiver of right to enforce noncompete agreement where employer did nothing when it initially learned of former employee's competing practice).

Employer Acts Constituting Waiver (cont'd)

- Support/assistance of employee. *Int'l Shared Servs., Inc. v. McCoy*, 259 A.D.2d 668, 686 N.Y.S.2d 828, 829 (2d Dep't 1999) (finding that former employer had "waived its right to enforce the restrictive covenant by knowingly aiding the defendant in his efforts to obtain competing employment").

Waiver or Estoppel – Employer's Past Practice

- Equitable defenses of waiver/estoppel often raised as a defense to the enforcement of a noncompete agreement.
- Success of defense is fact-specific. Courts will look at the **number**, the **recency**, and the **similarity** of past instances of failing to enforce the noncompete agreement.
- Generally, a company's enforcement (or lack thereof) of other employees' noncompete agreements does not amount to a waiver or estoppel of its contractual rights.

Waiver and the Treatment of Similarly Situated Parties

- Similar treatment/consistent enforcement of similarly situated parties can militate in favor of noncompete enforcement by showing a protectable interest.
- Disparate treatment can lead a court to conclude that a covenant to compete is unnecessary or that the employer has waived its rights to enforce the agreement.

Selective Enforcement

- Selective enforcement will rarely be enough on its own to constitute waiver:
  - *Minn. Mining &Mfg. Co. v. Kirkevald*, 87 F.R.D. 324, 336 (D. Minn. 1980) (finding waiver had not occurred where employer had failed to enforce covenant against other former employees who had possessed comparable confidential information and where employer had encouraged defendant to “explore the job market”).

Selective Enforcement/Waiver

- Selective enforcement will rarely be enough on its own to constitute waiver:
  - *Laidlaw, Inc. v. Student Transp. of Am., Inc.*, 20 F. Supp. 2d 727, 751 (D.N.J. 1998) (holding that waiver had not occurred where employer had not consistently enforced noncompete agreements, and that to hold otherwise would be impractical and unfair as it requires an employer to enforce every restrictive covenant without regard to cost effectiveness or individual circumstances).

Selective Enforcement/Waiver (cont'd)

- However, disparate treatment can lead a court to conclude that a covenant to compete is unnecessary:
  - *Gagliardi Bros., Inc. v. Caputo*, 538 F. Supp. 525, 529 (E.D. Pa. 1982) (finding that where company had not required employees to enter into restrictive covenants for five years prior to action, evidence suggested company did "not perceive any need for restrictive action, or else others would be subject to agreements such that sought to be enforced here").

Selective Enforcement/Waiver (cont'd)

- However, disparate treatment can lead a court to conclude that a covenant to compete is unnecessary:
  - *Gateway 2000, Inc. v. Kelley*, 9 F. Supp. 2d 795-96 (E.D. Mich. 1998) (where company switched type of noncompete agreement from general restriction to one that listed specific employers for which employee could not work, court found that former, general restriction agreement was overly broad and, therefore, invalid because narrower "list" agreement was adequate to protect its interests).

Waiver/Estoppel (cont'd)

Suggestions to Improve Your Chances

- It is advisable to consider including in the contract itself the considerations to be taken into account and the procedure for securing a waiver.
- It is inadvisable to have every employee execute a noncompete agreement regardless of the employee's access to confidential information or trade secrets because consistent enforcement can be helpful even though inconsistent enforcement is not fatal.

Bimbo Bakeries USA, Inc. v. Botticella

- Third Circuit adopts form of the "inevitable disclosure" doctrine
- Court enjoined executive from leaving national bakery to join a competitor in the absence of a noncompete agreement where Bimbo established that there was a threat of trade-secret disclosure
- Case decided under Pennsylvania's Uniform Trade Secrets Act
- Represented a departure from previous case law that suggested that an employer's burden was to establish that it was virtually impossible for an employee to work for a competitor without disclosing trade secrets, or that such disclosure was inevitable
- Found that nontechnical product knowledge was sufficiently protectable to support injunction
- Pre-hire conduct of employee seemed to influence judge

Broader Geographic Restrictions Case Law

- The emerging trend is to recognize broader geographic restrictions than in older jurisprudence
- Circumstances of the case must justify the geographic scope of the restrictions
- *Precisionir Inc. v. Clepper* (S.D.N.Y. 2010)—enforced a noncompete agreement that limited competition and customer solicitation anywhere in the United States and Canada

Case Law (cont'd)

- *Philips Electronics North America Corp. v. Hope* (M.D.N.C. 2009)—enforced nationwide noncompete restrictions given the nature of the employee's duties and the business of the employer
- *Universal Engraving Inc. v. Duarte* (D. Kan. 2007)—enforced a universal noncompete agreement in the context of an employee who had worldwide responsibilities and conducted worldwide research and development

Case Law (cont'd)

- *The Estee Lauder Companies, Inc. v. Batra* (S.D.N.Y. 2006)—upheld worldwide noncompete agreement given the universal responsibility of the employee and the international scope of the employer's industry

Hedging Your Bets on Expanding Geographic Restrictions

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