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NON-COMPETE AGREEMENTS

I. GENERAL RULES OF ENFORCEABILITY

a. Virginia

In *Parikh v. Family Care Center, Inc.*, 273 Va. 284 (2007), the Virginia Supreme Court summarized the test for enforcement of covenants not to compete:

> A covenant not to compete between an employer and an employee will be enforced if the covenant is narrowly written to protect the employer's legitimate business interest, is not unduly burdensome on the employee's ability to earn a living, and does not violate public policy. *Omniplex World Services Corp., v. U.S. Invest. Services, Inc.*, 270 Va. 246, 249, 618 S.E.2d 340, 342 (2005); *Modern Environments, Inc. v. Stinnett*, 263 Va. 491, 493, 561 S.E.2d 694, 695 (2002); *Simmons v. Miller*, 261 Va. 561, 580-81, 544 S.E.2d 666, 678 (2001). Restrictive covenants are disfavored restraints on trade and, therefore, the employer bears the burden of proof and any ambiguities in the contract will be construed in favor of the employee. *Simmons*, 261 Va. At 581, 544 S.E.2d at 678.
>
> We have recently stated that "[e]ach non-competition agreement must be evaluated on its own merits, balancing the provisions of the contract with the circumstances of the businesses and employees involved." *Omniplex World Services*, 270 Va. At 249, 618 S.E.2d at 343.

In the employment context, covenants not to compete are generally disfavored, and will be strictly construed against the employer. *Almers v. S.C. Nat'l Bank*, 217 S.E.2d 135 (S.C. 1975). At least one court has tempered this harsh rule with the recognition that "there is less justification for skepticism where both parties to the non-compete clause are established business entities and there is no evidence of a bargaining imbalance between the two entities." *Scansource, Inc. v. Thurston Group, LLC*, No. 11-0380, 2011 U.S. Dist. LEXIS 90660 (D. Md. Aug. 15, 2011).

As will be dealt with at greater length throughout this paper, it is worth emphasizing that entities only have a legitimate interest in preventing "unfair competition" and may not use restrictive covenants to prevent "ordinary competition". *Id.* In general, this distinction will turn on whether the competitive activity seeks to profit through exploitation of "good will" established on behalf of the Company, even if that goodwill was derived from the employee's own contributions. *Id.*; *Fournil v. Turbeville Ins. Agency, Inc.*, No. 3:07-3836, 2009 U.S. Dist. LEXIS 16303 (D.S.C. Mar. 2, 2009).

In *Fournil*, the court concluded that the covenant was overly broad and uunenforceable because it prevented defendant from soliciting business from clients with whom the defendant had formed no special relationship and of whom the defendant had no special knowledge. *Id.* By contrast, in *Scansource*, the non-compete clause was limited to "customers or prospective customers" with which defendant had contact during his employment.

b. <u>Maryland</u>

In order for a covenant not to compete to be enforceable under Maryland law, the covenant (1) must be supported by adequate consideration; (2) must be ancillary to the employment contract; (3) must be confined within limits that are no wider as to geographical area and duration than reasonably necessary for the protection of the business of the employer; and (4) must not impose an undue hardship on the employee or disregard the interest of the public. *Ecology Servs. v. Clym Envtl. Servs., LLC*, 181 Md. App. 1, 14-15, 952 A.2d 999, 1007 (2008) (citing *Becker v. Bailey*, 268 Md. 93, 96-97, 299 A. 2d 835, 837-38 (1973)). In addition to assessing the reasonableness of time and geographic restraints, courts applying Maryland law also review the scope of the activity an employer is attempting to limit. *Deutsche Post Global Mail, Ltd. v. Conrad*, 116 Fed. Appx. 435, 438 (4th Cir. 2004) (unpublished opinion) (under Maryland law, non-compete agreements must be no broader than reasonably necessary to protect the employer's interest).

The Fourth Circuit, interpreting Maryland law, phrased the requirements slightly differently, holding that for a covenant to be enforceable it must satisfy each of the following conditions:

1) The employer must have a legally protected interest;
2) The restrictive covenant must be no wider in scope eand duration than is reasonably necessary to protect the employer's interest;
3) The covenant cannot impose an undue hardship on the employee; and
4) The covenant cannot violate public policy.

Deutsche Post Global Mail, Ltd. v. Conrad, 116 F. App'x 435 (4th Cir. 2004). The focus of this inquiry is on the employer's interest in "preventing departing employees from taking with them the customer goodwill they helped to create for the employer."

II. ENFORCEABILITY OF UNSIGNED NON-COMPETE "AGREEMENTS"

a. <u>What if You Cannot Find a Signed Copy of the Non-Compete?</u>

In *United States Risk Mgmt., LLC v. Day*, 73 So. 3d 1100 (La. Ct. App. 2011), the employee argued that his non-compete was not binding, as the employer fhad failed to sign it. Indeed, the agreement explicitly stated that it was only effective upon "execution." Nonetheless, the Court held that there was a genuine issue of material fact concerning contract formation, and thus declined to dismiss the case, holding that "execution" of a contract can mean signing or performance by both parties.

b. <u>If the Employer Has Not Had the Employee Sign a Non-Compete, Can It Obtain an Injunction?</u>

In *Actuator Specialties, Inc. v. Chinavare*, 2011 Mich. App. LEXIS 2133 (Mich. Ct. App. Dec. 1, 2011), the Court of Appeals affirmed a three-year injunction which prohibited the defendant from working for a competitor after the evidence demonstrated that he had accessed computer files of his ex-employer close to the time of his termination. Even after the litigation was commenced, and after a TRO was issued, the defendant continued to upload these files to his new employer's server and copied allegedly the content of sensitive documents to fulfill customer orders. In light of this proof, the court affirmed what, in essence, amounted to a three-year industry non-compete, even though defendant had never signed a non-compete agreement.

III. Enforceability Where Employee is Terminated Without Cause

This is an issue that has resulted in various approaches by the state courts. In *Ruhl v. FA Bartlett Tree Expert Co.*, 225 A.2d 288 (Md. 1967), the Court of Appeals noted that "Ruhl's employment [had] been terminated by Bartlett through no fault of Ruhl's" and had it been otherwise, "a different legal situation might well have been presented." *Citing MacIntosh v. Brunswick Corp.*, 215 A.2d 222 (Md. 1965). Similarly, in *SIFCO Indus. Inc. v. Advanced Plating Tech., Inc.*, 867 F. Supp. 155 (S.D.N.Y. 1994), the court held that covenants not to compete were unenforceable where, upon acquiring the company with whom the employees had entered into covenants, the successor company terminated employees' positions by closing factory at which employees worked.

The Montana Supreme Court has held that employers are ordinarily not permitted to enforce a non-compete provision where the employer terminates the employment relationship. *Wrigg v. Junkermier, Clark, Campanella, Stevens, P.C.*, 265 P.3d 646 (Mt. 2011). Where an employee in Montana is terminated without cause, "courts should scrutinize highly a covenant's enforcement given the involuntary nature of the departure… An employer's decision to end the employment relationship reveals the employer's belief that the employee is incapable of generating profits for the employer. It would be disingenuous for an employer to claim that an employee was worthless to the business and simultaneously claim that the employee constituted an existential competitive threat." 265 P.3d at 652.

By contrast, Florida took a different approach in *Twenty Four Collection v. Keller*, 389 So. 2d 1062 (Fla. Dist. Ct. App. 1980). There, defendant-former employee had been discharged by plaintiff-former employer and was subject to a non-competition agreement which became effective "[i]n the event of the termination, voluntarily or involuntarily," of defendant's employment. Reversing a lower court's attempt to fashion an equitable remedy, the Court of Appeals held that "[t]here is no doubt either of the applicability of [Fla. Stat. § 542.12(2) (1977)] nor the enforceability of agreements which come within its terms" and further finding that the non-compete agreement to which defendant was subject "is specifically validated" by Fla. Stat. § 542.12(2) (1977). Finally, the Court held that, in general, the only authority it possesses of the terms of non-competitive agreements is "to determine, as the statute provides, the reasonableness of its time and area limitations." *Cf. also Ins. Assocs. Corp. v. Hansen*, 723 P.2d 190 (Idaho Ct. App. 1986) (enforcing non-compete without addressing circumstances of termination); *Weber v. Tillman*, 913 P.2d 84 (Kan. 1996) (enforcing non-compete without addressing fact that defendant was terminated without cause); *Cellular One, Inc. v. Boyd*, 653 So. 2d 30 (La. Ct. App. 1995) (no difference in analysis applied in upholding non-competes against two employees, one who resigned and one who was terminated); *Hogan v. Bergen Bruswig Corp.*, 378 A.2d 1164 (N.J. Super Ct. App. Div. 1977) (not addressing circumstances of dismissal).

However, as noted by the Indiana Court of Appeals in *Gomez v. Chua Med. Corp.*, 510 N.E.2d 191 (Ind. Ct. App. 1987), most courts will at least consider the circumstances surrounding the employee's termination. In *Gomez*, the Court found that there were "four basic alternatives" when an employee leaves employment:

1) The employee voluntarily leaves the employment;
2) The employee is discharged for good cause;
3) The employee is discharged in bad faith; and
4) The employee is terminated, but neither good cause nor bad faith appear to exist.

Several courts have shown reluctance to enforce even otherwise reasonable agreements against employees who are discharged without cause (*Bailey v. King*, 398 S.W.2d 906 (Ark. 1966)), who are constructively discharged (*Bishop v. Lakeland Animal Hosp., PC*, 644 N.E.2d 33 (Ill. App. Ct. 1994); *Ma & Pa., Inc. v. Kelly*, 342 N.W.2d 500 (Iowa 1984) or who would otherwise suffer "undue hardship" for being terminated through no fault of their own (*MacIntosh v. Brunswick Corp.*, 215 A.2d 222 (Md. 1965)). *See also Post v. Merrill Lynch, Pierce, Fennerr & Smith, Inc.*, 397 N.E.2d 358 (N.Y. 1979) ("Where the employer terminates the employment relationship without cause,…his action necessarily destroys the mutuality of obligation on which the covenant rests"); *In re UFG Int'l Inc.*, 225 B.R. 51 (Bankr. S.D.N.Y. 1998) ("an employer cannot hobble his employee by terminating him without cause and then enforcing a restriction that diminishes his ability to find comparable employment.") The Virginia Supreme Court, in *Clinch Valley Physicians, Inc. v. Garcia*, 414 S.E.2d 599 (Va. 1992), affirmed a lower court's decision not to enforce a covenant not to compete because the employee's termination had occurred when his contract lapsed. Interpreting the contract narrowly to require "cause" for termination, the Supreme Court affirmed.

IV. ENFORCEABILITY WHERE EMPLOYEE'S JOB DUTIES ARE SUBSEQUENTLY CHANGED

a. Material Changes Can Void the Agreement

In *AFC Cable Sys. Inc. v. Clisham*, 62 F. Supp. 2d 167 (D. Mass. 1999), the court held that "each time an employee's employment relationship with the employer changes materially such that they have entered into a new employment relationship, a restrictive covenant must be signed."

See also Lycos, Inc. v. Jackson, 18 Mass. L. Rep. 256, 2004 Mass. Super. LEXIS 348 (Mass. Super. Ct. Aug. 24, 2004).

This issue was also addressed by the Massachusetts Superior Court in *Grace Hunt IT Solutions, LLC v. SIS Software, LLC*, Civ. No. 12-80-BLS1 (Massachusetts Superior Court Feb. 14, 2012) (Lauriat, J.), copy available at http://www.massachusettsnoncompetelaw.com/uploads/file/Grace%20Hunt%281%29.pdf. In *Grace Hunt*, certain employees had signed non-compete agreements with plaintiff's predecessor company. After the purchase of the predecessor by plaintiff, plaintiff requested that these employees sign a new non-compete agreement. Also at this time, plaintiff changed its compensation structure to lower the base salary, but providing a mechanism whereby employees could "make up" the difference through bonuses for billable hours. Some employees refused to sign the non-compete agreements. Approximately one month later, defendant contacted employee, and individual defendant, Mr. John Joyce regarding potentially joining defendant's organization. Mr. Joyce expressed his interest and also forwarded the contact information to two other employees of plaintiff that he believed might be interested in working for defendant. All three individuals received job offers. Shortly thereafter, each of the three employees resigned and notified certain clients that they were leaving plaintiff, though they claim that they did not encourage them to switch to defendant. Several clients chose to switch regardless. In early 2012, plaintiff filed suit against the three individuals for breach of contract and breach of fiduciary duty for soliciting clients while still employed by plaintiff.

The court found that the original non-compete, while reasonable, was unenforceable because the defendants' employment relationship had undergone a "material change". Under Massachusetts law, a "material change" in the employment relationship renders a non-compete agreement void. That certain aspects of defendants' compensation had improved under the new relationship was "immaterial" because other aspects of their compensation were worse.

Not all changes will constitute a "material" change, however. In *Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412 (3d Cir. 2010), the Third Circuit – in the context of determining the enforceability of a covenant not to compete after a stock sale – held that "[a] change in corporate culture alone cannot invalidate a legally binding contract." The court went on to explain that "[i]f [defendant's] employment agreement with [plaintiff] was intended to be contingent upon [plaintiff] continuing as a family-owned and operated business, those terms should have been included as material conditions[.]"

b. A Possible Contractual Solution

It may be possible to contract around this problem with a carefully drafted non-compete agreement. Plaintiff in *TEKSystems, Inc. v. Fletcher*, No. 10-1145, 2011 U.S. Dist. LEXIS 22227 (D. Md. Mar. 2, 2011) tried, albeit unsuccessfully, to do just that. In that case, defendant was subject to a non-compete agreement containing the following clause:

> The parties hereto understand that this Agreement shall remain in effect notwithstanding any job change or job assignment by EMPLOYEE within TEKsystems or its organization.

The Agreement also defined the term "TEKsystems" as "TEKsystems, Inc." and the term "TEKsystems Companies" to include TEKsystems, Inc. and its subsidiaries/affiliates. Defendant contended that the non-compete period began running when he transferred to a subsidiary of TEKsystems, while plaintiff argued that the above language indicated that the Agreement had remained in effect until defendant left the subsidiary which, it contended, was a member of the TEKsystems "organization".

The court held that defendant's interpretation was "the most logical". The court explained that to hold that the above language encompassed subsidiaries of TEKsystems would "require this Court to ignore the Agreement's defined terms" which distinguished between "TEKsystems" and "TEKsystems Companies". While noting that the ambiguous undefined term "organization" could be interpreted to extend to cover subsidiaries, the court construed this ambiguity against "the party who made it or caused it to be made" – TEKsystems. *See also Almers v. S.C. Nat'l Bank*, 217 S.E.2d 135 (S.C. 1975) (noting that restrictive covenants will be strictly construed against the employer).

While the court did not expressly rule on the validity or effect of such a clause should it be applicable, it appears that a well-drafted clause may well defeat the problem of a material change in employee responsibilities voiding a non-compete.

V. Inferring a Duty Not to Compete

In *RRC Ne., LLC v. BAA Md., Inc.*, 2010 Md. LEXIS 181 (Md. May 10, 2001) plaintiff-sublessee brought this action against defendant-sublessor, alleging that defendant breached express and implied covenants of good faith and fair dealing when defendant breach a promise to limit its competition in Baltimore-Washington International airport to four stores.

The Court of Appeals stated:

> "An implied covenant to refrain from destructive competition may be inferred from a percentage lease, based on the duty of good faith and fair dealing, where the intentions of the parties, as indicated by the terms of the lease and the circumstances surrounding the formation of the lease, suggest that such an inference is appropriate, namely, by limiting competition to a particular level with, or granting exclusivity to, the plaintiff, either in the contract or an incorporated pre-lease document."

However, as plaintiff's complaint failed to allege sufficiently that the parties contracted and agreed to limit competition, such a duty could not be inferred. Thus, the court affirmed dismissal of plaintiff's complaint.

VI. ADEQUACY OF CONTINUED EMPLOYMENT AS CONSIDERATION

a. Is Continued Employment Adequate Consideration for a Non-Compete Agreement?

1. In General

The Courts are split on this question, for example, the Colorado Supreme Court, in *Lucht's Concrete Pumping, Inc. v. Horner,* 255 P.3d 1058 (May 31, 2011), held that the continued employment of an at-will employee is adequate consideration for a non-compete agreement. *See also Ackerman v. Kimball Int'l, Inc.*, 652 N.E.2d 507, 509 (Ind. 1995); *Sherman v. Pfefferkorn,* 135 N.E.2d 568, 569 (Mass. 1922); *Brignull v. Albert*, 666 A.2d 82, 84 (Me. 1995); *Camco, Inc. v. Baker*, 936 P.2d 829, 931-32 (Nev. 1997); *Lake Land Emp't Grp. of Akron, LLC v. Columber*, 804 N.E.2d 27, 31-32 (Ohio 2004); *Summits 7, Inc. v. Kelly*, 886 A.2d 365, 373 (Vt. 2005); *Research & Trading Corp. v. Powell*, 468 A.2d 1301, 1305 (Del. Ch. 1983); *Lake Land Empl't Grp v. Columber*, 804 N.E.2d 27 (Ohio 2004).

In *Marsh United States, Inc. v. Marsh & McLennan Cos., Inc.*, 354 S.W.3d 764 (Tx. 2011), the Texas Supreme Court upheld a non-compete requirement in a stock option agreement. The court held that the agreement was proper consideration for enforceability of a non-compete agreement because it related to the protection of the employer's good will in the business.

In contrast, the Texas Supreme Court, in *Light v. Centel Cellular Co. of Tex.*, 883 S.W.2d 642, 644 (Tex. 2006) has held that, as a promise of continued at-will employment is illusory that it cannot generally constitute consideration for a valid contract. *See also Mona Electric Group, Inc. v. Truland Serv. Corp.*, 193 F. Supp. 2d 874 (E.D. Va. 2002) (deciding that the Virginia Supreme Court would probably not find that continued employment, standing alone, to constitute sufficient consideration for a restrictive covenant after employment has already commenced);; *Access Organics Inc. v. Hernandez,* 175 P.3d 899, 904 (Mont. 2008) (noting that because the employee and employer are not on equal bargaining ground, "in the context of non-compete agreements with existing employees, we require clear evidence that the employee received good consideration"); *Timenterial, Inc. v. Dagata*, 277 A.2d 512 (Conn. Super. Ct. 1971); *Forrest Paschal Mach. Co. v. Milholen,* 220 S.E.2d 190 (N.C. Ct. App. 1975) (restrictive covenant entered into five days after start of employment lacked consideration); *Admiral Servs., Inc. v. Drebit,* No. Civ. A. 95-1086, 1995 WL 134812 (E.D. Pa. Mar. 28, 1995) (continued employment for an indefinite period not sufficient consideration); *Poole v. Incentives Unlimited, Inc.*, 548 S.E.2d 207 (S.C. 2001) (covenant not to compete after start of employment requires separate consideration).

2. While Continued Employment May Be Consideration for a Non-Compete, Employer Must Still Actually Demand the Non-Compete

In *Workflow Solutions v. Lewis*, 77 Va. Cir. 334 (Va. Cir. Ct. City of Norfolk Dec. 12, 2008), the employee-defendant resigned under contentious circumstances involving his pre-termination solicitation of employer-plaintiff's accounts. Subsequently, plaintiff and defendant reached an agreement that defendant would continue to work for plaintiff for a six-month, at-will period, with an option to continue, subject to defendant signing a non-compete. Defendant continued to work for plaintiff for several years but never actually signed the non-compete.

In 2008, defendant left the company, at which point plaintiff sued to compel defendant to execute the non-compete contract.

The court dismissed the case, holding that it was powerless to enforce anything, as the agreement contemplated defendant's signature, which plaintiff failed to demand.

However, it may be enough that the non-compete agreement is actually made, even if verbally. In *Wade S. Dunbar Ins. Agency, Inc. v. Barber*, 556 S.E.2d 331 (N.C. App. 2001), the court held that a non-competition covenant in the original verbal employment contract is supported by adequate consideration and the fact that the written contract was executed after the employee started work is insignificant. In the instant case, the contract stated that the employee acknowledges and agrees that the terms of the non-compete provision were fully discussed and agreed upon prior to the date of execution and prior to the employee's commencement of work.

<u>Take Aways</u>

- As always, know the law of your jurisdiction on this issue;
- If continued employment is not adequate consideration, then provide something of value to the employee as consideration, *e.g.*, a salary increase, a bonus, specialized training, or confidential information. *See Pearson v. Visual Innovations Co.*, 2006 Tex. App. LEXIS 2795 *12-*13, *13 n.6 (Tex. Ct. App. April 6, 2006) (collecting cases offering non-illusory consideration).

<u>b.</u> <u>Does the Length of Continued Employment Affect the Court's Judgment on the Adequacy of the Consideration?</u>

Absolutely. For example, the Maryland Court of Special Appeals, in *Simko v. Graymar Co.*, 464 A.2d 1104, 1107 (Md. Ct. Spec. App. 1983) held: "Were an employer to discharge an employee without cause in an unconscionably short length of time after extracting the employee's signature to a restrictive covenant through a threat of discharge, there would be a failure of the consideration." *See also Summits 7, Inc. v. Kelly*, 886 A.2d 365, 373 (Vt. 2005) ("…legitimate consideration for the covenant exists as long as the employer does not act in bad faith by terminating the employee shortly after the employee signs the covenant."); *Freeman v. The Duluth Clinic, Ltd.*, 334 N.W.2d 626, 630 (Minn. 1983) ("continuation of employment can be used to uphold coercive agreements, but the covenant must be bargained for and provide the employee with real advantages."); *Holloman v. Circuit City Stores, Inc.*, 894 A.2d 547 (Md. 2006) (sufficient consideration where the agreement allowed the employer to terminate or modify the agreement upon 30 days written notice at the end of any year because the employer was bound to comply with the agreement for an entire year before it could discontinue it).

c. <u>How do the Courts Distinguish Between Non-Compete Covenants Signed on the First Day of Employment and Those Signed After Employment Has Commenced?</u>

In *Pollard Group, Inc. v. Labriola*, 152 Wn.2d 828 (Wash. 2004) the Washington state Supreme Court held that non-compete agreements, entered into after employment has commenced, are valid only when there is independent consideration given at the time the agreement is reached. The Court held that continued at-will employment is not valid consideration for a non-compete agreement. The Court emphasized that independent consideration means that both parties to the agreement must each acquire additional obligations and benefits as a result of entering into the agreement. The Court stated that independent, additional, consideration is required for the valid formation of a modification or subsequent agreement, and that there is no consideration when one party is to perform some additional obligation while the other party is simply to perform that which he promised in the original contract.

In Oregon, non-compete agreements which are not entered into at the start of employment are generally void under Or. Rev. Stat. § 653.295. In *First Allmerica Fin. Life Ins. Co. v. Sumner*, 212 F. Supp. 2d 1235 (D. Or. 2002), the court had to decide whether a prohibition on inducing insurance policy holders to terminate or replace policies falls within the definition of a non-competition agreement, and whether providing a severance package and a favorable compensation formula as consideration for the non-compete constitutes "bona fide advancement." The court held that the non-solicitation constituted a non-competition agreement and the severance not to be "bona fide advancement." Thus, as the agreement was not executed at the inception of employment, it was not enforceable.

In *Paramount Termite Control Co., Inc. v. Rector*, 380 S.E.2d 922 (Va. 1989), Judge Whiting delivered the opinion of the court in a case where defendant-former employees argued that no consideration was ever provided for their non-compete agreements because the agreements were signed after they were already employed. The court, however, found consideration in the employer's decision to allow the employee's access to sensitive information as an exchange for the employees' promises not to compete, though the employer could have terminated the employees at its choosing.

VII. PROTECTION OF LEGITIMATE BUSINESS INTEREST

a. <u>Non-Compete Agreements Must Protect A Legitimate Interest</u>

1. Introduction

To be enforceable, restrictive covenants must serve a legitimate business interest of the party seeking enforcement. In general, this means that an employer can enforce a restrictive covenant only against those employees who "provide unique services" or "to prevent the future misuse of trade secrets, routes, or lists of clients, or solicitation of customers." *Becker v. Bailey*, 299 A.2d 835 (Md. 1973). In *Fowler v. Printers II, Inc.*, 598 A.2d 794 (Md. Ct. Spec. App. 1991), defendants, former salespeople for plaintiff, argued that the restrictive covenants they had signed with plaintiff, their former employer, were unenforceable because they were overbroad. The Maryland Court of special appeals noted that, given only monetary damages actually suffered by plaintiff as a result of defendants' breach were awarded below, that the question of whether the covenant was otherwise overbroad was not before it. *Id.* at 463-64.

In *Sunbelt Rentals, Inc. v. Ehlers*, 915 N.E.2d 862 (Ill. App. Ct. 2009), [overruled in *Reliable Fire Equipment Co. v. Arredondo*, 2011 IL 111871; 2011 Ill. LEXIS 1836 (Ill. Dec. 1, 2011)] the intermediate appellate court reviewed the well-established "legitimate business interest" test, used for decades in Illinois in deciding whether a non-compete clause was enforceable. Thereafter, Federal Judge Gettleman, in *Aspen Marketing Servs., Inc. v. Russell*, Civil No. 09-c-2864, 2009 U.S. Dist. LEXIS 112982 (N.D. Ill. Dec. 3, 2009), while noting *Sunbelt*, nonetheless applied the legitimate business test while stating that "[t]he Illinois Supreme Court, United States Court of Appeals for the Seventh Circuit, and this court, however, have not rejected the applications of the legitimate business interests test."

It is important to note that noncompetition covenants which are ancillary to the sale of a business, rather than contained in an employment agreement, are viewed with less disfavor by courts and may not be subject to the same requirements. In *Wenzell v. Ingrim*, 228 P.3d 103 (Alaska 2010) the Alaska Supreme Court noted that, while non-competition agreements ancillary to employment agreements are generally disfavored, that the enforceability of a non-competition agreement ancillary to the sale of a business was a question of first impression in Alaska. While covenants ancillary to employment contracts are "scrutinized with particular care because they are often the product of unequal bargaining power, this level of scrutiny is not applied to covenants ancillary to the sale of a business because the contracting parties are more likely to be of equal bargaining power." *Id.* at 110 (internal quotations omitted). The court went on to explain that, in the context of the sale of a business, the "legitimate interest" which may be protected is the "value of the good will that [the purchaser] has acquired[.]" *Id.* (quoting Restatement (Second) of Contracts § § 186, 188).

In *T.J.T., Inc. v. Mori*, 266 P.3d 476 (Id. 2011), the Idaho Supreme Court, applying California law and reversing a district court decision, found that a two-year non-compete agreement executed in connection with the sale of a business was enforceable, despite the fact that the seller also became an employee of the purchasing company as a result of the sale. The *T.J.T.* court noted that "California courts have held that a non-competition agreement can be incidentally linked to the seller's employment agreement with the buying business without offending section 16600 [which prohibits non-compete agreements generally]." 266 P.3d at 480.

The Court vacated the lower court's refusal to enforce the non-compete and remanded for further proceedings. *See also Bryceland v. Northey*, 772 P.2d 36 (Ariz. Ct. App. 1989) (noting that courts are more willing to enforce covenants ancillary to the sale of a business "because of the need to see that goodwill is effectively transferred"); *McAndless v. Carpenter*, 848 P.2d 444

(Idaho App. 1993); *Boulanger v. Dunkin' Donuts, Inc.*, 815 N.E.2d 572 (Mass. 2004) (noting that concerns about inequality of bargaining power carry less weight in this context).

2. The Nature of Protectable "Legitimate Interests"

At its most basic, businesspeople have a legitimate, protectable interest in "preventing an employee from using the contacts established during employment to pirate the employer's customers." *Holloway v. Faw, Casson & Co.*, 572 A.2d 510 (Md. 1990); *Ruhl v. F.A. Bartlett Tree Expert Co.*, 225 A.2d 288 (Md. 1967); *Millward v. Gerstung Int'l Sports Educ., Inc.*, 302 A.2d 13 (Md. 1973); *Becker v. Bailey*, 299 A.2d 835 (Md. 1973). This notion, while uncontroversial, is also not particularly enlightening.

In *Holloway*, the Maryland Court of Appeals noted that there were several types of employment situations which tended to create a protectable interest sufficient to enforce a non-competition agreement. One occurs where "a part of the compensated services of the former employee consisted in the creation of the good will of customers and clients which is likely to follow the person of the former employee." *Holloway*, 572 A.2d at 515 (quoting *Silver v. Goldberger*, 188 A.2d 1 (Md. 1963)). On the other hand, restraint is not justified merely because the employee is an effective competitor. *Id.* The court found that the former employee in the case before it was in a position to establish a personal relationship with his employer's clients. Accordingly, it held that the employer had a legitimate and protectable interest in restraining competition by Mr. Holloway, and turned to examining the extent of that interest.

In *Intelus Corp. v. Barton*, 7 F. Supp. 2d 635 (D. Md. 1998) the district court reaffirmed that an employer's interest in restraining competitive activity by its employees "is strongest for businesses in which the personal contacts between the employee and the customer are an important element determining the business's success. The key distinction drawn by the court is between the employer's right to protect the good will which it paid its employees to develop and the "right of a talented employee to become a more efficient competitor because of his experience and knowledge." In short, the employer's protectable interest is in its *goodwill*, not in protecting itself from competitive harm from a former employee. In *Intelus Corp*., the court found that the employer had a protectable interest because its business depended largely on the personal contacts of employees such as defendant. While recognizing that "an order forcing a person to switch, or delay employment is a serious matter[]", the court was persuaded that the substantive scope of the restriction was sufficiently narrow to permit defendant to find other work in his field, and enforced the covenant.

A non-compete clause may be void, either on its face or as applied, if it is based on an interest which is not protectable. As the court noted in *Severn Mktg. Assocs., Inc. v. Doolin,* No. CCB-09-3295, 2010 U.S. Dist. LEXIS 102992 (D. Md. Sept. 29, 2010), even if the scope of a covenant is not unreasonable on its face, it may still be void "if, in determining enforceability, other facts and circumstances reveal that the clause is unreasonable." *See also Millward v.*

Gerstung Int'l Sport Educ., Inc., 302 A.2d 14 (Md. 1973); *Budget Rent A Car of Wash., Inc. v. Raab*, 302 A.2d 11 (Md. 1973).

In *Doolin*, the defendant-former employee attacked the non-compete clause for covering an excessive number of potential employers and an excessively large geographic area ("most of three states and the District of Columbia"). Withholding its decision to await further development of the factual record, the court noted that whether the clause was overbroad on its face was a "close question", explaining that the necessity of the restriction to protect the employer's interests, the employee's hardship, and the public interest "often turn[] on facts and circumstances outside the four corners of the restrictive covenant."

3. *Non-Competes Which Are Not Tailored to Circumstances of Employee's Employment and Duties May Be Unduly Burdensome*

Under both Virginia and Maryland law, a covenant not to compete must not unduly burden the employee's ability to earn a living. *See, e.g., Omniplex World Services Corp.*, 270 Va. at 249, 618 S.E.2d at 342; *Modern Environments, Inc. v. Stinnett*, 263 Va. 491, 493, 561 S.E.2d 694, 695 (2002); *Simmons v. Miller*, 261 Va. 561, 580-81, 544 S.E.2d 666, 678 (2001); *Holloway v. Faw, Casson & Co. (Holloway II)*, 319 Md. 324, 334, 572 A.2d 510, 515 (1990); *Ruhl v. F.A. Bartlett Tree Expert Co.*, 245 Md. 118, 127, 225 A.2d 288, 293 (1967).

In *Modern Environments*, the Virginia Supreme Court addressed a situation in which plaintiff was party to a non-competition agreement with his former employer that prohibited him from working with any of his former employer's competitors in any capacity. Plaintiff filed a declaratory judgment action to establish that the non-compete agreement was overbroad and unenforceable. Defendants failed to present any evidence of any legitimate business interest that is served by prohibiting the employee from being employed in any capacity by a competing employer. Based on that record, the court affirmed the trial court's decision that the non-compete agreement was unenforceable.

In *BB&T Ins. Servs., Inc. v. Thomas Rutherfoord, Inc.*, 2010 Va. Cir. LEXIS 25 (Va. Cir. Ct. City of Richmond Feb. 9, 2010), the plaintiff-former employer alleged that the defendants-former employees accepted employment with plaintiff's competitor in violation of the defendants' covenants not to compete contained in their employment agreements. The defendants did not challenge the restrictive period or geographic area, but rather the restrictive "functions," which precluded the defendants from engaging in "the sale, trade or service of attempted sale, trade or service of insurance products" for anyone whom the defendants contacted regarding plaintiff's business within two years prior to defendants' termination, or anyone who ever purchased products or services from plaintiff, regardless if said purchases involved defendants or if said customers remain customers of plaintiff.

Because the prohibition was not tailored to limit defendants' employment to that which would be in competition with plaintiff, the court found the restrictive covenant unduly burdensome on defendants and thus overbroad and unenforceable. Specifically, the court stated: "Defendants persuasively argue, for example, that [defendants] could not encourage a [plaintiff] employee, or an independent contractor janitor that services the office, to pursue higher education. [Defendants] also appear[] to be prohibited from working for a rental car company because [they] would be required to 'sell' or offer insurance for the vehicles rented by the company."

Similarly, in *Lasership, Inc. v. Watson*, 2009 Va. Cir. LEXIS 64 (Va. Cir. Ct. Fairfax County Aug. 12, 2009), the court found the employee's non-compete overbroad and unenforceable where the language attempted to limit the restriction such that the employee could work for a competitor in a noncompeting capacity. The language at issue stated: the restriction "applies only to those services rendered by . . . an office or unit of the Company in which Employee worked." The court took issue with the fact that the provision was not limited to the same *functions* that the employee performed for the employer. The court continued, "[t]his [provision] would essentially bar the employee from performing or rendering services provided by anyone else in an office or unit that the employee worked, including janitorial, secretarial, administrative, or managerial work with which the employee had no meaningful interaction."

The court also found overbroad the employee's non-solicitation restriction, which prohibited the employee from "contacting in any manner, directly or indirectly, soliciting or agreeing to perform services of any type that the Company can render for any of Company's Customers." The court noted that the restriction would prevent an employee from "contacting in *any manner*, for *any purpose, any customer*" of the employer, thus rendering the non-solicitation provision unenforceable. *See also Strategic Enter. Solutions, Inc. v. Ikuma*, 77 Va. Cir. 179 (Va. Cir. Ct. Fairfax County Oct. 7, 2008).

In *Roanoke Eng'g Sales v. Rosenbaum*, 290 S.E.2d 882 (Va. 1982), the Court addressed in detail the criteria to be applied to determine if a non-compete agreement supersedes the restraint necessary to protect and employer's legitimate business interests:

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 interest?
2) From the standpoint of the employee, is the restraint reasonable in the sense that it is not unduly harsh and oppressive in curtailing legitimate efforts to earn a livelihood?
3) Is the restraint reasonable from the standpoint of a sound public policy?

Non-compete agreements that satisfy these criteria will be enforced in equity. In the case at hand, the criteria were met, but the term of the violated non-compete agreement expired before the case was decided. To avoid an inequitable result and maintain the integrity of such agreements, the court enjoined the former employee from competing for 30 months, six months less than the original term of the non-compete agreement.

For later affirmations of this case, *see Advanced Marine Enters., Inc. v. PRC, Inc.*, 501 S.E.2d 148 (Va. 1998); *Rash v. Hilb, Rogal & Hamilton Co. of Richmond*, 467 S.E.2d 791 (Va. 1996); *New River Media Group v. Knighton*, 429 S.E.2d 25 (Va. 1993); *Paramount Termite Control*

Co., Inc. v. Rector, 380 S.E.2d 922 (Va. 1989); *Mona Elec. Group, Inc. v. Truland Serv. Corp.*, 6 Fed. Appx. 108 (4th Cir. 2003).

4. Courts Will Consider Whether the Covenant is Restricted to Those Products or Services on Which the Employee Actually Worked for the Employer

In both Virginia and Maryland, in determining whether a restrictive covenant is narrowly written to protect the employer's legitimate business interest, courts often consider the variety of products and services which the employer offers, and whether the employee is only proscribed in competing against the employer in connection with those particular products or services which he or she actually worked with while previously employed by the company. Cases discussing this requirement include:

1) *KBH Corp. v. David R. McGeorge Car Co.*, No. 080371 (Va. Dec. 12, 2008) (striking down a non-compete covenant drafted by a wholesaler of used cars which sought to restrict former employees from affiliating with "any business which purchases, sells, or distributes, automobiles");
2) *Nortec Communications, Inc. v. Lee-Llacer*, 548 F. Supp. 2d 226 (E.D. Va. 2008) (holding that a covenant not to compete would be enforceable only if "the proscribed functions are the *same* functions as were performed for the former employer") (quoting *Lanmark Tech., Inc. v. Canales*, 454 F. Supp. 2d 524, 528 (E.D. Va. 2006) (emphasis in original);
3) *Deutsche Post Global Mail*, 116 Fed. Appx. at 438 (applying Maryland law, the Court reviewed the scope of the activity that the employer was attempting to limit).

5. Other Cases Discussing Overbreadth Which Led to Unenforceability

For cases holding that similar language was overbroad and therefore unenforceable, *see, e.g.:*

1) *Pais v. Automation Prods.*, 36 Va. Cir. 230, 234-35, 238-39 (Newport News Cir. Ct. 1995) (holding that a non-compete agreement containing a "prospective customer" clause was unenforceable by reason of "overbreadth and unreasonableness," that the clause "prohibit[ed] [the employee] from dealing with anyone with whom [the former employer] has had any dealings, regardless of whether the business involved" the employee's line of work, and that under the restriction, the employee would be unable to pursue a livelihood in that line of work in the relevant region);
2) *Innovative Sys. & Solutions, Inc. v. Hannah*, 75 Va. Cir. 363 (Norfolk Cir. Ct. 2008) (holding that a non-compete agreement was overbroad and unenforceable, in part due to a restriction which applied to the employer's "Prospects," and noting that "the word 'prospects' can include any person or entity that might, at any time in the future, come to the [former employer's] attention");
3) *Hebb v. Stump, Harvey & Cook, Inc.*, 25 Md. App. 478, 487-89, 334 A.2d 563, 569-70 (1975) (in upholding trial court's holding that a non-compete agreement's "restrictions against dealing with prospective customers… could not be enforced," holding that "[t]he

trial court correctly limited the class of prohibited customers by excluding those appellant brought with him and those who were described as prospective customers in the agreement," and noting the importance of having a customer restriction be "limited to a specific, identifiable class").

4) *Devnew v. Flagship Group, Ltd.*, 75 Va. Cir. 436, 449 (Norfolk Cir. Ct. 2006) (in initial negotiations over the terms of a non-compete agreement, the employer agreed to eliminate a restriction from competing with prospective customers "upon advice of counsel that the restrictions were overly broad and unenforceable").

6. Determination of a Covenant Not to Compete's Enforceability Requires and Individualized Inquiry

In the final analysis, the enforceability of a covenant not to compete will vary not only from employer to employer and job to job but also from employee to employee. In *Delaware Elevator, Inc. v. Williams*, 2011 Del. Ch. LEXIS 47 (Del. Ch. March 16, 2011), the court noted that, under Maryland law, the court should consider the following factors when deciding whether to enforce a non-compete:

- Whether the person against whom enforcement is sought is skilled or offers unique services
- Whether the covenant is necessary to prevent the solicitation of customers
- Whether the covenant is necessary to prevent the use of trade secrets
- Whether there is any exploitation of personal contacts between the employee and the customer; and
- Whether enforcement would impose undue hardship on the employee or disregard interests of the public.

Id. at *20-*21. The court, quoting *Becker v. Bailey*, 299 A.2d 835 (Md. 1973), noted that "[w]hile [covenants not to compete] may be enforced under some circumstances, there is no sure measuring device designed to calculate when they are. Rather, a determination must be made based on the scope of each particular covenant itself; and, if that is not too broad on its face, the facts and circumstances **of each case** must be examined." *Delaware Elevator*, 2011 Del. Ch. LEXIS 47 at *21 (internal quotations omitted) (emphasis added).

In *Becker v. Bailey*, the Maryland Court of Appeals noted that there "is no arbitrary yardstick as to what protection of the business of the employer is reasonably necessary, no categorical measurement of what constitutes undue hardship on the employee, no precise scales to weigh the interest of the public…the determination must be made on the particular circumstances." 299 A.2d 835.

In examining the interplay of the above factors, the court in *Delaware Elevator* held that the geographic scope of a covenant must be examined in tandem with its temporal duration, noting that, all else being equal, the permissible length of a covenant will bear – to some extent – an inverse relationship to its geographic scope. Applying that reasoning, the court found that a three-year, 100-mile radius restriction on competition was unreasonable. In so holding, the court noted that it would force the defendant to relocate or seek a new line of work. The court went on to explain that "[i]t is one thing to force a relatively young, mobile, single person to relocate or change jobs. Their ties are few and switching costs are low. [Defendant] has been in the workforce…some thirty-four years…[he] has a wife, a home, and longstanding personal ties to the tri-state area. He cannot readily relocate." The court also found that defendants' salary was insufficient to afford to simply "ride out" the three year non-compete.

7. Certain Substantive Prohibitions Overbroad as a Matter of Law

In *MCS Servs., Inc. v. Jones*, No. WMN-10-1042, 2010 U.S. Dist. LEXIS 105013 (D. Md. Oct. 1, 2010) the court was faced with a non-compete which provided that defendant "shall not…directly or indirectly…be employed by…any other entity…in competition with, or similar in nature to, [MCS]." The court noted that this "sweeping prohibition" restrained defendant "from working in any capacity with any company that competes or may compete in any way with [plaintiff]." The court found that such a prohibition was "not reasonably necessary to protect the customer goodwill [defendant] created and it is not narrowly tailored to that end." The court went on to find that such a restriction would severely harm defendant by limiting his potential employers. In so holding, the court noted that the application of the non-compete was not restricted to prohibiting defendant from providing services to a competitor similar to those he provided to plaintiff, but would "prevent [defendant] from working in any capacity for a competitor, even if his responsibilities were wholly unrelated to" those performed for plaintiff. The court found that the non-competition agreement was unenforceable as a matter of law.

In reaching that decision, the court relied in part on on the Fourth Circuit's decision in *Deutsche Post Global Mail, Ltd. v. Conrad*, 116 Fed. Appx. 435, 438 (4th Cir. 2004). There, the Fourth Circuit held that a non-competition covenant was unenforceable because "[i]n no way is it specifically targeted at preventing [defendants] from trading on the goodwill they created while serving [plaintiff's] customers." The court further explained that an employer may not prevent "any kind of competition" – only that which it has a protected interest in preventing.

Nevertheless, certain courts have enforced sweeping non-compete agreements. *See, e.g., Intelus Corp. v. Barton*, 7 F. Supp. 2d 635 (D. Md. 1998); *PADCO Advisors, Inc. v. Omdahl*, 179 F. Supp. 2d 600 (D. Md. 2002); *TEKsystems, Inc. v. Bolton*, No. RDB-08-3099, 2010 U.S. Dist. LEXIS 9651 (D. Md. Feb. 4, 2010); *MCS Servs., Inc. v. Garcia*, No. 289729, 2008 Md. Cir. Ct. LEXIS 3 (Cir. Ct. Md. Mar. 4, 2008).

T*EKsystems* provides a good example of the reasoning in the above decisions. In that case, the court, while noting that covenants not to compete will be enforced if "the particular restraint is reasonable on the specific facts" nevertheless enforced a covenant which prohibited defendant from engaging "in *any* activity which *may* affect adversely the interests of the Company[.]" 2010 U.S. Dist. LEXIS 9651 at *15. The court declined to adopt the "inflexible mandate" advocated by plaintiff – that a covenant "must be specifically targeted at preventing the employee from trading on the good will he or she created while serving an employer's customers." This reasoning was criticized by the court in *MCS*, which argued that it was a "departure from the Fourth Circuit's teaching" and that "this Court therefore declines to follow them."

8. Must a Company List its Competitors?

Employees subject to restrictive covenants routinely argue that they are harsh, oppressive, or otherwise unenforceable when they fail to specifically identify their current competitors or customers. The court in *Scansource, Inc. v. Thurston Group, LLC*, No. 11-0380, 2011 U.S. Dist. LEXIS 90660 (D. Md. Aug. 15, 2011) dealt with such a situation. There, defendant complained that a restrictive covenant to which it was subject curtailed its legitimate efforts to earn a livelihood because "the agreement does not contain a list of [plaintiff's] current customers." Arguing that, absent such a list, defendant has no reliable method of determining which companies it is prohibited from providing services to, defendant asked the court to find that the agreement was unenforceable as a matter of law.

The court reserved ruling on this issue pending discovery. Noting that both the number of plaintiff's customers and the impact of the non-compete clause on defendant's business prospects were discoverable issues, the court declined to rule. Allowing discovery to go forward, the court explained that "[a]t this early stage of the litigation it would be improper to state as a matter of law that the covenant is unduly harsh…it is unclear how many customers [defendant] may have encountered…[and] it cannot be determined from the alleged facts whether the non-compete clause is reasonable from the standpoint of sound policy."

9. Illinois Supreme Court Upholds Legitimate Business Interest Requirement

In *Sunbelt Rentals v. Ehlers*, 915 N.E.2d 862 (Ill. App. Ct. 2009), the Court rejected the universal requirement that an employer, seeking to enforce a non-compete, establish a legitimate business interest to support the non-compete covenant. The Illinois Supreme Court, in *Reliable Fire Equip. v. Arredondo*, 2011 IL 111871; 2011 Ill. LEXIS 1836 (Ill. Dec. 1, 2011), rejected *Sunbelt Rentals*, holding that the traditional three-part reasonableness framework remains the law, and that the courts must consider the totality of the circumstances in assessing whether the restraint is no greater than necessary for the employer's protection. Shortly thereafter, the Supreme Court of Montana, in *Wrigg v. Junkermier, Clark, Campanella, Stevens, P.C.*, 2011 MT 290, (Nov. 22, 2011), also held that an employer must "establish a legitimate business interest as a threshold step to [a court's] analysis of the reasonableness of the covenant."

b. "Amicable" Resolutions Serve as Later Evidence of Legitimate Business Interests?

In *Estee Lauder Cos. v. Bartra*, 430 F. Supp. 2d 158 (S.D.N.Y. 2006) the federal district court for the Southern District of New York was asked to enforce a worldwide non-compete agreement against defendant with a duration of twelve months. While the court found that neither the geographical scope nor the time period of the non-compete was inherently unreasonable, given that the plaintiff had agreed to continue paying defendant's full salary during that time, it nevertheless reduced the duration from twelve months to five. In so doing, the court reasoned that "[defendant's] general behavior surrounding the enforcement of restrictive covenants suggests that such a length of time is generally unnecessary" to protect its legitimate business interests. To reach this conclusion, the court noted that "similar covenants not to compete have not been enforced against other members of [plaintiff's] management for twelve full months." In addition, it appears that plaintiff originally offered to reduce the duration of the non-compete to four months upon his departure.

The court went on to explain:

> While it might be argued that these reductions were based upon an amicable agreement amongst the parties…this distinction is not relevant. In New York, covenants not to compete shall only be enforced for the length of time for which the employer's confidential information will be competitively valuable. It is concluded that…plaintiff's offer of four months reflects a recognition on its part that four months would be sufficient to protect its interests.

VIII. GEOGRAPHIC SCOPE

In *TradeStaff & Co. v. Nogiec*, 77 Va. Cir. 77 (Va. Cir. Ct. City of Chesapeake Sept. 4, 2008) defendant's restrictive covenant with plaintiff read as follows:

> "Employee . . . agrees that for a period of two years after termination of his/her employment with TradeStaff in any manner, whether with or without cause, voluntary, involuntary, or by mutual consent, the employee will not, within the State of Virginia, or any other state where TradeStaff provides labor, directly or indirectly engage in the business of providing labor personnel, including but not limited to, carpenters, electricians, plumbers, general laborers, masons, etc. to companies performing work in the construction industry, (i.e. "Labor provider"), or in any business competitive with TradeStaff. Directly or indirectly engaging in the business of "labor provider" or in any competitive business shall include engaging in such business as an owner, partner, or agent, or as an employee of any person, firm, or corporation engaged in such business or in being interested directly or indirectly in any such business conducted by any person, firm, or corporation."

The court held that because the above was unlimited in both its geographic and functional scope, it was overly broad and unenforceable. With regards to the provision's geographic scope, the court noted that while defendant served plaintiff in the Hampton Roads area, the non-compete prohibited defendant from working "within the State of Virginia, or any other state where [plaintiff] provides labor." As such, the provision was overly broad because it was not limited to the area formerly served by defendant or within a set mile radius from defendant's former service territory. *See also ManTech Int'l Corp. v. Analex Corp.*, 75 Va. Cir. 354 (Va. Cir. Ct. Fairfax County July 18, 2008).

As for the functional scope, the court found the provision so broad that the defendant "could not even purchase stocks from a publicly traded company if that company could be termed a competitor or in a competitive business with [plaintiff]." Essentially, as with the geographic restriction, the functional restriction "may also morph and grow to encompass industries wholly different and apart from those engaged in by the former employee or even in existence at the time the employee worked for [plaintiff]."

More generally, both Virginia and Maryland law provide that a geographic-based restriction is not necessarily required, but the omission of such a restriction is only acceptable so long as the agreement otherwise contains a reasonable customer-based restriction. *See, e.g., Foti v. Cook*, 220 Va. 800, 806-07, 263 S.E.2d 430, 434 (1980); *Fowler v. Printers II*, 89 Md. App. 448, 598 A.2d 794, 799 (1991).

However, while covenants not to compete must generally be limited to an appropriate geographic area, in certain circumstances "prohibitions against contacting existing customers can be a valid substitute for a geographic limitation." *See Wolf v. Colonial Life & Accident Ins. Co.*, 420 S.E.2d 217 (S.C. 1992); *See also Caine & Estes Ins. Agency, Inc. v. Watts*, 293 S.E.2d 859 (S.C. 1982); *Oxman v. Profitt*, 126 S.E.2d 852 (S.C. 1962). New York has also upheld non-solicitation agreements imposing client-based restrictions without geographic limitations as reasonable in scope. *Malcolm v. Pirnie, Inc.*, 720 N.Y.S.2d 863 (N.Y. App. Div. 2001); *Mallory Factor, Inc. v. Schwartz*, 536 N.Y.S.2d 752, 754 (N.Y. App. Div. 1989); *Bates Chevrolet, Inc. v. Haven Chevrolet, Inc.*, 213 N.Y.S.2d 577, 581 (N.Y. App. Div. 1961).

Generally, restrictive covenants are enforceable if they are ancillary to an employment agreement, the geographic scope is reasonably limited to such territory as may be reasonably necessary for the protectin of the employer, without imposing harm to the public or undue hardship on the employee. *LCI Communicaiotns, Inc. v. Wilson*, 700 F. Supp. 1390 (W.D. Pa. 1988) (applying Ohio law); *Girard v. Rebsamen Ins. Co.*, 685 S.W.2d 526 (Ark. App. 1985); *Evans Lab., Inc. v. Melder*, 562 S.W.2d 62 (Ark. 1978) ; *Millward v. Gerstung Int'l Sport Educ. Inc.*, 302 A.2d 14 (Md. 1973).

IX. DURATION

a. <u>Interaction of Duration and Legitimate Business Interests</u>

Courts have differed over the proper manner in which to determine the proper duration of an employer's legitimate interests in restricting competitive activity by a former employer. In *Bed Mart, Inc. v. Kelley*, 45 P.3d 1219 (Ariz. 2002), the court found that the employer had a legitimate interest in having a reasonable amount of time to overcome former employee's loss. This time was to be measured by the normal time required to hire a replacement and give that replacement time to establish working relationships. A somewhat different approach was adopted by the court in *Unisource Worldwide, Inc. v. Carrara*, 244 F. Supp. 2d 977, 982 (C.D. Ill. 2003). There, the court held that the employer's legitimate interest could be measured in terms of the length of time it would take for the former employee's competitive edge to become "stale".

Also of interest is the decision of the *Farr v. Thomas*, [2007] EWCA Civ 118 (Ct. of App. Civ. Div'n 2007) in which a UK court upheld a covenant not to compete with a twelve-month duration. While this decision would be unremarkable in the United States, it caused a stir in the United Kingdom where, prior to this decision, many commentators believed that a non-compete agreement of such a duration would be unenforceable.

b. Possible Approaches to Justifying the Duration of a Non-Compete

One approach is to establish that the duration equates with the time that it will take the employer to hire and train a replacement. *See, e.g., Bed Mart, Inc. v. Kelley*, 45 P.3d 1219 (Ariz. Ct. App. 2002) Court found employer had a legitimate interest in having a reasonable amount of time to overcome former employee's loss, usually by hiring a replacement and giving that replacement time to establish working relationships.).

Another approach would be the "competitive edge" approach. In such circumstance, one may need expert testimony to establish the "shelf life" of such competitive edge. *See Unisource Worldwide, Inc. v. Carrara*, 244 F. Supp. 2d 977, 982 (C.D. Ill. 2003) (holding that two years was an unreasonable period of time to enforce a non-compete covenant because the prices, costs, and consumer information relevant to a distributor's operations at any particular time were volatile and subject to change.).

c. Duration of Non-Compete Agreements and Non-Compliance

1. Equitable Tolling

In *Whelan Sec. Co. v. Kennebrew*, 2011 Mo. App. LEXIS 1590 (Mo. Ct. App. Nov. 29, 2011), the Missouri Court of Appeals declined to toll the time remaining on a non-compete agreement during the period in which the employee is in breach. The Court emphasized that the employer still had a claim for damages, but that injunctive relief was not available given the lapse of the non-compete period.

Similarly, the First Circuit, applying Massachusetts law, held that specific relief (as distinguished from money damages) was unavailable when contractual period contained in a non-compete had run. *See EMC Corp. v. Arturi*, 655 F.3d 75 (1st Cir. 2011). The Court characterized Massachusetts' position in this regard as "unequivocal" and noted the "frosty climate for…attempts to avoid it." Finally, the First Circuit explained that the object of the rule was the "familiar concern with the unequal bargaining power of employee and employer[.]"

In contrast, Ohio allows equitable tolling, *Homan, Inc. v. A1 AG Servs., LLC*, 885 N.E.2d 253 (Ohio Ct. App. 2008), and, Illinois will only approve equitable tolling if the non-compete contains a clear contractual provision expressly providing for equitable tolling. *See also Trim-Line of Toledo v. Carroll* 1987 Ohio App. LEXIS 5937 (6th Dist. Feb. 25, 1982).

Finally the Eastern District of Virginia appears to have endorsed equitable tolling. *See W. Insulation, L.P. v. Moore*, 2008 U.S. Dist. LEXIS 4390 (E.D. Va. Jan. 22, 2008).

2. Contractual Extension During Non-Compliance

The obvious solution to the problems described above regarding the reluctance of some courts to embrace equitable tolling in the case of non-compliance is to provide in the covenant itself that it will be extended by the duration of any periods of noncompliance. Even this may not ensure extension of the non-compete period, however. *See A-Copy, Inc. v. Michaelson*, 599 F.2d 450 (1st Cir. 1978) (concluding that specific relief is unavailable after the non-compete period has lapsed).

In *Thermatool v. Borzym*, 227 Mich. App. 366 (Mich. Ct. App. 1998), the Michigan Court of Appeals noted that courts in other jurisdictions "have held that, under appropriate circumstances, an agreement not to compete can be extended beyond its stated expiration date as a remedy for a breach of the agreement." The reasoning for this has varied, from the difficulty of determining damages (*Basicomputer Corp. v. Scott*, 973 F.2d 507 (6th Cir. 1992)), to allowing the plaintiff to regain customers lost during the breach (*Levitt Corp. v. Levitt*, 593 F.2d 463 (2d Cir. 1979)), as well as preventing a party from benefiting from their own breach of contract (*Roanoke Engineering Sales Co., Inc. v. Rosenbaum*, 290 S.E.2d 882 (1982). The court found that the primary reason for *refusing* to extend the agreement was that the parties had not provided for the extension in the original contract. *See, e.g., Moraine Indus. Supply, Inc. v. Sterling Rubber Prods. Co.*, 891 F.2d 133 (6th Cir. 1989); *Olin Water Servs. v. Midland Research Labs., Inc.*, 774 F.2d 303 (8th Cir. 1985); *Gaylord Broad. Co. v. Cosmos Broad. Corp.*, 746 F.2d 251 (5th Cir. 1984).

While the court in *Thermatool* concluded that, in appropriate circumstances, extension is available as a remedy, it declined to impose it on the specific facts before it, examining the same factors that courts routinely use when considering injunctive relief.

d. Extension of Duration of Non-Compete Period as a Remedy

The Courts are split as to whether the employer is entitled to get the non-compete period extended as a remedy for a breach. Some courts have held that the court's have broad inherent power to extend the duration of a restrictive covenant as an equitable remedy for breach. *See, e.g., Rogers v. Runfola*, 57 Ohio St. 3d 5, 8-9 (1991). Other courts have held that the duration of a restrictive covenant may only be extended as a remedy for breach if the Parties included language in the restrictive covenant that authorizes such a remedy. *See, e.g., KX Indus., LP v. Saaski*, No. cv-960386806S, 1997 Conn. Super. LEXIS 2444 (Conn. Super. Ct. Aug. 29, 1997);

6 Richard A. Lord, *Williston on Contracts* § 13:5 (4th ed. 2011). Finally, some courts have held that the contractually-specified duration of a restrictive covenant may never be extended by a court as a remedy for breach. *See, e.g., Wilson v. Chemco Chemical Co.*, 711 S.W. 2d 265, 268 (Tex. App. 1986).

Take-Aways

- Know the law of your jurisdiction on this issue, if there be any caselaw.
- Include, in the non-compete, language that authorizes the court to extend the duration of the non-compete time period in the event of a breach.

X. AMBIGUOUS OR VAGUE TERMS

a. Ambiguous Terms Such as "Indirect" or "Similar" May Make Non-Compete Unenforceable

Courts may refuse to enforce non-compete agreements which are ambiguous or capable of leading to absurd results. For example, in *Lampman v. DeWolff Boberg & Assocs., Inc.*, 319 Fed. Appx. 293 (4th Cir. 2009), the Court was faced with the enforceability of plaintiff's non-compete clause, which provided:

> [Plaintiff] agrees that he [] will not, directly or indirectly, engage in competition with [defendant], without the express written consent of [defendant]'s Chief Executive Officer . . . for a period of three (3) years following the termination of his [] employment . . . for any reason . . . For purposes of this Agreement, "Competition" shall mean, with respect to [plaintiff], any of the following . . . *Serving in any capacity*, job or function . . . *for any Person* that analyzes, designs, modifies and implements management systems to improve productivity, quality, service and capacity levels that generates quantifiable financial savings, and where such services are competitive with *or similar to those* that [plaintiff] rendered during his [] employment with [defendant]."

Along with the provision's complete lack of geographic restrictions—the court noted that "[t]he non-competition clause would prohibit [plaintiff] from working for a 'competitor' in Zimbabwe, even though [defendant] does not provide services in that country and has no legitimate interest in prohibiting [plaintiff] from working there"—the court also pointed to the above italicized, ambiguous phrases as grounds to render the covenant unreasonable under South Carolina law.

In addition, the court pointed to the non-compete's use of the terms "indirect" and "similar," which, in certain circumstances, could lead to absurd results. For example, noted that if plaintiff were to work for, say, Ford Motor analyzing its "management operating systems" to develop models for internal cost savings, plaintiff would be in violation of the covenant, even though "Ford could not be deemed a direct or indirect competitor of" defendant.

Similarly, in *Nortec Commc'ns., Inc. v. Lee-Llacer*, 548 F. Supp. 2d 226 (E.D. Va. 2008), the court confronted the issue of whether the defendant-employee's non-compete and non-solicitation restrictive covenants were facially overbroad so as to render them unenforceable.

Regarding the defendant's non-compete, the court held that the provision's prohibition against the defendant from "working for an existing customer or client of [plaintiff] to the extent that the employment relates to *products or services offered by* [plaintiff]" did not necessarily relate to defendant's former employment with plaintiff, nor did it involve the use of an "skills or knowledge acquired" by plaintiff in his former employment.

Regarding the defendant's non-solicitation restriction, the provision contained phrases such as "urge or suggest," "solicit, encourage or induce," and "interfere with or disrupt," which, the court held, rendered the restriction overly broad due to its "use of ambiguous language." As such, the court found the defendant's restrictive covenants invalid and unenforceable.

b. Vague Language Will Not Always Defeat a Non-Compete Agreement

In contrast, the Court in *Cole v. Champion Enters., Inc.*, 305 Fed. Appx. 122 (4th Cir. 2008) enforced a non-compete agreement despite the broad and vague language which it contained. In *Cole*, the appellant-former employee's non-compete prohibited him for two years following the termination of his employment from: "directly or indirectly . . . engage[ing] in, becom[ing] financially interested in, or hav[ing] any connection with, any business located in the United States or Canada engaged in the production, sales, financing, insuring, or marketing of manufactured homes of the development of manufactured housing parks." The former employee sought to recover damages he allegedly incurred while adhering to the covenant's two-year restriction, arguing that the provision was overly broad and unenforceable.

Applying Michigan law, the Fourth Circuit held that the restriction was valid as (1) it was reasonable in scope and (2) the appellee-former employer had a legitimate business interest to protect. As to the former, the scope was reasonable as the former employer's business was "geographically broad enough" to cover the U.S. and Canada. And, as the former employee, as an executive officer, "had confidential and propriety knowledge about all aspects of [the former employer's] business . . . [the former employer] thus had an interest in keeping [the appellant] out of the market for a reasonable amount of time, as his entrance into the market could have threatened the distribution channels which were such a large part of [the former employer's] core business."

c. Ohio Court Finds Otherwise Ambiguous Terms To Be Industry "Term-of-Art"

In *Osei-Tutu Owusu, M.D. v. Hope Cancer of Nw. Ohio, Inc.*, 2011 Ohio 4466 (Ohio Ct. App. 2011), the non-compete defined the doctor's post-employment restricted area as "the primary service area of Lima, Ohio and the primary service area of Van Wert, Ohio." The defendant doctor claimed not to understand what "primary service area" meant, arguing that it was ambiguous and thus unenforceable. The former employer contended that the term was a term commonly used in the healthcare industry. The trial court agreed with the doctor, holding that the signatories "did not know specifically what geographical area that terminology encompassed at the time they signed the Agreement." The Court of Appeals reversed, finding that the terminology was an industry "term-of-art" which could easily be construed based upon industry standards and common usages.

XI. Non-Compete Agreements in Particular Industries and Involving Specific Types of Workers

a. Certain Types of Employees or Services May Not Be Subject to Non-Competes

In *Ecology Servs. v. Clym Envtl. Servs., LLC*, 181 Md. App. 1 (Md. Ct. Spec. App. July 7, 2008), *cert. denied*, 406 Md. 444 (2008), Ecology Services prevailed in a bidding process to provide services at the National Institute of Health. Ecology Services employed defendants to provide said services; the contract for services contained covenants not to compete whereby "for a period of one (1) year after the cessation of . . . employment with [Ecology Services] for any reason whatsoever and within a radius of one hundred (100) miles from [Ecology Service's] principal place of business . . . [c]ompete with [Ecology Services] or in any manner whatsoever engage in any business similar to that of [Ecology Services] in any capacity, . . . [s]olicit or induce any employee of [Ecology Services] to leave the employ of [Ecology Services], . . . [s]olicit or accept employment by or be retained by any person or entity who, at any time during the Employee's employment with [Ecology Services] was a competitor of [Ecology Services] or was a person or entity that contracted with [Ecology Services]."

In plaintiff's instant action to enforce the above provision, the parties did not dispute whether the non-compete was reasonable as to "time or place," but rather whether, under *Budget Rent A Car of Wash., Inc. v. Raab*, 268 Md. 478, 482 (1973), "the person sought be enjoined is an unskilled worker whose services are not unique; whether the covenant is necessary to prevent the solicitation of customers or the use of trade secrets, assigned routes, or private customer lists; whether there is any exploitation of personal contacts between the employee and customer; and, whether enforcement of the clause would impose an undue hardship on the employee or disregard the interests of the public."

Applying the above factors, the court found the non-compete provision unenforceable, as follows: (1) Ecology Services failed to establish an issue of fact as to whether defendants exploited personal contacts with NIH and, indeed, whether defendants even had access to trade secrets during their employment; (2) Ecology Services failed to establish that defendants possessed unique or specialized skills; and (3) enforcement of the non-compete would exact undue hardship on the defendants, given, namely, their length of service at NIH and lack of additional job opportunities.

b. Non-Competes Applicable to “Employees” May Not Be Enforceable Against Independent Contractors

In *Mansell v. Toys "R" Us, Inc.*, 673 F. Supp. 2d 407 (D. Md. Dec. 10, 2009), plaintiff brought suit to enforce an agreement with defendant for plaintiff to supply defendant with workers to unload merchandise deliveries. Plaintiff argued that defendant had agreed, in addition to the rate and timing of payment for services, “not to do business with any employees of [plaintiff] during the course of [the] relationship and for a period of 3 years after the end of [the] relationship.” After the parties ceased doing business, plaintiff alleged that defendant hired plaintiff employees in contravention of the agreement; defendant argued that it never agreed to the restrictive covenant not to hire plaintiff’s employees.

The court held for the defendant, finding that strictly construing the covenant against its draft, plaintiff, the agreement’s use of the word “employees” precluded enforcement of the agreement in favor of plaintiff, as plaintiff previously testified that it made its workers agree in writing not to be called employees, but rather independent contractors. Hence, the court found that plaintiff could not now succeed in a breach of contract claim against defendant for “doing business” with plaintiff’s “employees.”

c. Medical Practice Non Compete Agreements: Discovery of Former Employee-Doctor’s Patient Records

One troublesome issue that has arisen in non-compete litigation involving doctors who have left a practice group to either set up their own practice or join another practice is whether the former practice group can obtain, in discovery, the identity of the departing doctor’s patients in order to establish its damages.

The Michigan Court of Appeals, in *Steiner v. Bonanni*, 292 Mich. App. 265 (Mich. Ct. App. April 7, 2011), held that, while HIPAA asserts supremacy over state law, it allows for the application of state law regarding physician-patient privilege, if the state law is more protective of patients’ privacy rights, and the Court then went on to hold that Michigan law does not provide for disclosure in judicial proceedings, does not authorize disclosure under a qualified protective order, and protects the mere existence of a patient-physician relationship from disclosure.

1. The Case of Tennessee

Over the last several years, Tennessee has struggled with non-compete agreements with physicians in private practice. In 2005, the Tennessee Supreme Court held that non-compete agreements were unenforceable against physicians and, presumably, other healthcare providers. *Murfreesboro Med. Clinic, P.A. v. Udom*, 166 S.W.3d 675 (Tenn. 2005). In 2008 the Tennessee legislature passed legislation to expressly permit healthcare provider non-compete agreements. Tenn. Code Ann. § 63-1-148 (effective July 1, 2008); *See also* Josh A. McCreary, *Physician Non-Compete Agreements Revisited & Revised*, 43 Tenn. B J. Vol. 8 (Aug. 2007). But, the statute stated that non-compete restraints “shall not be binding on a health care provider who has been employed by, or under contract with, the employing or contracting entity for at least six years.” Effective April 30, 2010, the Tennessee legislature passed an amendment that seemingly permitted non-compete restraints on healthcare providers who had been employed more than six years, and the legislature further modified the statute in 2012.

2. Medical Practice Non Compete Agreements Generally

The American Medical Association policy states that “covenants not to compete restrict competition, disrupt continuity of care, and potentially deprive the public of medical services.” The AMA says that non-compete agreements are unethical if excessive in scope.

In *Deutsch v. Barsky*, the D.C. Court of Appeals overturned a trial court’s decision because the trial court had failed to consider the likely injury to the public in a non-compete involving two dentists. 795 A.2d 669 (D.C. 2002). In so holding, the Court relied on *Iredell Digestive Disease Clinic v. Petrozza*, in which the North Carolina Court of Appeals stated that “the public’s interest in adequate health care must predominate over the parties’ freedom of contract.” 373 S.E.2d 449 (N.C. Ct. App. 1998).

By contrast, Illinois has repeatedly enforced restrictive covenants in the medical professional context. *See Mohanty v. St. John Heart Clinic, S.C.*, 225 Ill. 2d 52, 866 N.E.2d 85 (Ill. 2006) (holding that restrictive covenants in physician employment contracts were not void as against public policy); *Cockerill v. Wilson*, 51 Ill. 2d 179, 281 N.E.2d 648 (Ill. 1972) (upholding a restrictive covenant precluding a veterinarian from practicing medicine or operating an animal health supply store or a small animal clinic within a certain area); *Canfield v. Spear*, 44 Ill. 2d 49, 254 N.E.2d 433 (Ill. 1969) (holding that where the limitations in a non-compete clause as to time and territory was not unreasonably, the agreement was valid and enforceable against a group of doctors); *Bauer v. Sawyer*, 8 Ill. 2d 351, 134 N.E.2d 329 (Ill. 1956) (enforcing a restraint of trade covenant against a doctor where the covenant was found to not be injurious to the public and did not cause undue hardship to the doctor); *Ryan v. Hamilton*, 205 Ill. 191, 68 N.E.2d 781 (Ill. 1903) (holding that restrictive covenants were reasonable and enforceable against a doctor). Some courts have concluded that the Illinois Supreme Court assumes the presence of a legitimate business interest in cases involving medical professionals. *See e.g. Retina Servs., Ltd. V. Garoon*, 182 Ill. App. 3d 851, 538 N.E.2d 651 (Ill. App. Ct. 1989) (stating that “the Illinois Supreme Court’s consistent enforcement of such covenants in the medical professional field, where the duration and geography scope is reasonable, demonstrates its recognition that a professional medical practice is a protectable business interest.”).

Regarding the issue of whether restrictive covenants in the medical professional context are treated differently than restrictive covenants in other contexts, Justice Steigmann stated as follows in his dissenting opinion in *Lifetec, Inc. v. Edwards*, 377 Ill. App. 3d 260, 280, 880 N.E.2d 188, 204 (Ill. App. Ct. 2007):

> It makes no sense to place a greater burden on employers of salespeople than on employers of physicians when the enforceability of noncompete covenants is at issue. Surely the physician-patient relationship and access to medical care are more societally significant concerns than any concerns related to the relationship between a retailer of medical products and its sales force. I find support in this view in Justice Freeman's partial concurrence in Mohanty, where he wrote, "a strong case exists for abolishing all physician restrictive covenants as being against public policy. However, I agree that this decision is for the General Assembly to make."

(internal citation omitted).

In some states the "unique" or "extraordinary" skills possessed by doctors may, on a case-by-case or market-by-market basis, be found to justify a reasonable covenant not to compete. *See BDO Seidman v. Hirshberg*, 12 N.E.2d 1220 (N.Y. 1999).

3. Public Interest Considerations in Physician Non-Competes

Courts have been reluctant to enforce otherwise valid non-competes against physicians when doing so would be injurious to the "public interest". In *Cmty. Hosp. Group, Inc. v. More*, 869 A.2d 884 (N.J. 2005), the New Jersey Supreme Court reversed the decision of a lower court to enforce just such an agreement because the lower court had "failed to focus on the adverse impact the geographic restriction [in the non-compete agreement] would have on neurological patients seeking treatment at [defendant's employer's] emergency room. Without [defendant]…necessary neurological treatment to an emergency room patient could be compromised." *Id.* at 899. Accordingly, the Court found that there was "overwhelming" evidence that prohibiting Defendant from attending neurological patients in the geographical area specified would injure the public interest. The Court, while prepared to accept a non-compete covering a limited geographical distance "less than thirteen miles", specifically instructed the lower court, on remand, that any geographical restriction should exclude defendant's current employer. *Id.* at 900. *See also Duneland Emergency Physicians Med. Group v. Brunk*, 723 N.E.2d 963 (Ind. Ct. App. 2000) (restrictive covenant unenforceable when it would compromise emergency room care); *Premier Health Care Servs., Inc. v. Schneiderman*, 2001 Ohio 7087 (Oh. Ct. App. Dec. 28, 2001) (public interest weighed against granting injunction against physician-defendant); *Emergicare Sys. Corp. v. Bourdon*, 942 S.W.2d 201 (Tex. Ct. App. 1997) (refusing to enforce covenant that would have prevented doctor from serving public as emergency doctor).

d. <u>The Broadcast Industry: Validity of Non-Compete Agreements</u>

Several states, including Arizona, Illinois, Massachusetts, and Maine, as well as the District of Columbia, have laws which prevent the application of non-compete agreements in the broadcast industry. Marlo D. Brawer, *Switching Stations: The Battle Over Non-Competition Agreements in the Broadcasting Industry*, 27 Okla. City U. L. Rev. 693 (Summer 2002).

e. <u>The Legal Industry</u>

Restrictive covenants related to lawyers are generally distinguished both from those incident to the sale of a business and from those restricting post-employment competition. In *Dwyer v. Jung*, 133 N.J. Super. 343 (N.J. Super. Ct. 1975), the court refused to apply commercial standards in evaluating the reasonableness of restrictive covenants applicable to lawyers, noting the strong public policy considerations in this area. Explaining that the attorney-client relationship is "consensual, highly fiduciary on the part of counsel" the court found that the restrictive covenant was unethical as a violation of the then-current *Disciplinary Rules of the Code of Professional Responsibility*, DR 2-108(A) of the American Bar Association. *See also Denburg v. Parker Chapin Flattau & Klimpl*, 624 N.E.2d 995 (N.Y. 1993). Despite the broad acceptance of this principle, some states will enforce agreements which place a cost on, rather than outright prohibiting, competition. *See, e.g., Howard v. Babcock*, 863 P.2d 150 (Cal. 1993). Most states, however, hew to a *per se* rule prohibiting restrictions on attorney competition. *See Cmty. Hosp. Group, Inc. v. More*, 869 A.2d 884 (N.J. 2005); *Whiteside v. Griffis & Griffis, P.C.*, 902 S.W.2d 739 (Tex. App. 1995).

XII. COMPETING VERSUS PREPARING TO COMPETE

When ruling upon the contours of an employee's duty of loyalty to his employer or former employer, courts in both Virginia and Maryland make a distinction between an employee preparing to compete against his employer, as opposed to actually competing against the employer – preparing to compete is generally allowed, while actually competing against one's employer is a breach of the duty of loyalty. *See, e.g., Scientific Enters., Inc. v. George*, 47 Va. Cir. 9, 14 (Fairfax Cir. Ct. 1998) (while holding that employees "[must] not compete with their employer while they remain on the employer's payroll," also noting that "the policy in favor of free competition enables employees to prepare or make arrangements to compete with their employers without fear of violating their fiduciary duty of loyalty"); *Maryland Metals, Inc. v. Metzner*, 282 Md. 31, 38, 382 A.2d 564, 569 (1978) (same).

This is also a live issue in the United Kingdom. In *Foster Bryant Surveying Ltd. v. Bryant*, [2007] EWCA Civ. 200 (Court of Appeal 2007), the court found that a departing director was compelled by the duty of loyalty to avoid "any conflict of interest" and that this "exacting requirement[]" would be "exactingly enforced." Despite this strong language, the court did recognize that the application of these principles requires "care and sensitivity" to competing rights, such as the individual's freedom to compete "where that does not intrude on the misuse of the company's property." Accordingly, the court affirmed the lower court's decision that the defendant had not breached his fiduciary duties under the circumstances.

XIII. "BLUE PENCILING" AND "RED PENCILING"

a. <u>When Will "Blue Penciling" Be Permitted?</u>

1. Blue Pencilling is Permitted Under Maryland Law So Long As The Covenant is not a Deliberate Attempt to Place Unreasonable or Oppressive Restrictions on the Employee

In Maryland, the offending language of a covenant not to compete can be "blue-penciled" or excised to reduce the covenant's reach to reasonable limits in certain circumstances.

In 1989, the Maryland Court of Special Appeals noted:

> The typical response in the reported appellate decisions in this State, in which the Courts have ruled a portion of an employee non-competition agreement invalid, has been to "blue pencil" (cross out) the violative portions of the agreement and, if the excised portions are severable, to permit the agreement to stand minus the unenforceable wording; otherwise the entire agreement is void.

Holloway v. Faw, Casson & Co. (Holloway I), 78 Md. App. 205, 552 A.2d 1311, 1324 (1989), *aff'd in part and rev'd in part*, 572 A.2d 510, 511 (Md. 1990). *See also Nationwide Mut. Ins. Co. v. Hart*, 73 Md. App. 406, 534 A.2d 999, 1002 (1988). However, the *Holloway I* court adopted a more flexible blue pencil approach:

> The gist of the test applied… [under]… the flexible approach is essentially a two part inquiry: (1) Does the restrictive covenant as a whole evidence a deliberate intent by the employer to place unreasonable and oppressive restraints on the employee / covenantee? If so, then the entire covenant is invalidated, whether severable or not. (2) If the agreement, although unreasonable, satisfies the test in part 1, then the court should modify the express terms so as to align the reasonable expectations of the parties to the reasonable expectations of the law.

552 A.2d at 1327. On certiorari, however, the Maryland Court of Appeals declined to reach the issue of whether the blue pencil rule applied below was in fact part of Maryland law. *Holloway II*, 319 Md. at 326-27, 353, 572 A.2d at 511, 524.

In 1991, the Court of Special Appeals held that '"blue pencil' excision of offending contractual language" was "entirely in accord with Maryland law," but only so long as such excision could be performed "without supplementation or rearrangement of any language." *Fowler*, 89 Md. App. at 465-66, 598 A.2d at 802. The Fourth Circuit Court of Appeals, applying Maryland law, summarized the Maryland "blue-penciling" standard as follows:

> If a restrictive covenant is unnecessarily broad, a court may blue pencil or excise language to reduce the covenant's reach to reasonable limits. *See Tawney v. Mut. System of Maryland*, 186

> Md. 508, 47 A.2d 372, 379 (Md. 1946). However, under the blue pencil rule, a court may not rearrange or supplement the language of the restrictive covenant. *Fowler v. Printers II, Inc.*, 89 Md. App. 448, 598 A.2d 794, 802 (Md. Ct. Spec. App. 1991). A court can only blue pencil a restrictive covenant if the offending provision is neatly severable. According to the Maryland Court of Appeals, the principle underlying the blue pencil rule is articulated in the First Restatement of Contracts, which provides: 'When a promise in reasonable restraint of trade in a bargain has added to it a promise in unreasonable restraint, the former promise is enforceable unless the entire agreement is part of a plan to obtain a monopoly; but if full performance of a promise indivisible in terms would involve unreasonable restraint, the promise is illegal and is not enforceable even for so much of the performance as would be a reasonable restraint.' *Holloway*, 572 A.2d at 518 (quoting Restatement (First) of Contracts § 518).

Deutsche Post Global Mail, 116 Fed. Appx. at 439-40.

2. *Blue Penciling Rejected in Virginia*

In *Better Living Components, Inc. v. Coleman*, 2005 Va. Cir. LEXIS 145 (Va. Albemarle Cir. Ct. 2005), Judge Hogshire delivered the opinion of the court on the following facts: In 1997, Mr. Coleman was employed by Better Living and signed a contract with a two-year non-compete agreement that began at the termination of Mr. Coleman's employment. In 2004, Mr. Coleman quit working at Better Living and began working for Blue Ridge where he sold the same products in the same geographical area. The court looked at three factors in determining whether non-compete agreements are to be upheld in equity: 1) did the employer write the agreement so as to reasonably protect a justifiable business interest; 2) is the agreement not so unduly harsh as to impair the employee's ability to obtain a livelihood; 3) is the restraint reasonable from the standpoint of a sound public policy? The court also considered whether it was appropriate for the court to "blue pencil" – excise and rewrite language in agreements that act as restraints on trade to make the agreement comply with the law – the non-compete agreement. Another line of jurisprudence takes "blue penciling" one step further by allowing courts to insert language into the agreement to make it more reasonable.

Virginia as a state has declined to adopt a blue pencil rule, and the court here followed suit. *See also Wiley v. Royal Cup, Inc.*, 370 S.E.2d 744 (Ga. 1988) (Georgia does not recognize a blue pencil rule.); *Samuel Stores, Inc. v. Abrams*, 108 A.2d 541 (Conn. 1919)) (Connecticut does not recognize a blue pencil rule.); *but see Holloway v. Faw, Casson & Co.*, 572 A.2d 510 (Md. 1990) (Maryland follows to a blue pencil rule.); *Reddy v. Cmty. Health Found. of Man*, 298 S.E.2d 906 (W. Va. 1982) (West Virginia follows a blue pencil rule.); *E. Bus. Forms, Inc. v. Kistler*, 189 S.E.2d 22 (S.C. 1972) (South Carolina follows a blue pencil rule.); *Prof'l Liab. Consultants v. Todd*, 468 S.E.2d 201 (N.C. 1996) (North Carolina follows a narrow blue pencil rule.).

In *Better Living*, the non-compete agreement failed the *Roanoke* test because of the overbroad restriction on professional activities. The non-compete agreement proscribed mere employment by a company that was in direct or indirect competition with Better Living. That is, Mr. Coleman would be prohibited from being a comptroller at a company that has a little geographical overlap with Better Living and sells the same products. The court found this to be unreasonable and, following what it determined to be the Virginia Supreme Court's predilection, refused to blue pencil the non-compete agreement. Mr. Coleman's demurrer was upheld. *See Pitchford v. Oakwood Mobile Homes*, 124 F. Supp. 2d 958 (W.D. Va. 2000) (Applying Virginia law and recognizing that Virginia courts have consistently refused to employ the "blue pencil" doctrine); *See also* Griffin Toronjo Pivateau, *Putting the Blue Pencil Down: An Argument for Specificity in Noncompete Agreements*, 86 Neb. L. Rev. 672 (2008); Charles Sullivan, *The Puzzling Persistence off Unenforceable Contract Terms*, 77 Ohio St. L.J. 1127 (2009).

3. Blue Penciling in D.C. – An Open Question

Courts in the District of Columbia have not specifically adopted the "blue pencil" rule. In *Ellis v. James V. Hurston Assocs., Inc.*, 565 A.2d 615 (D.C. 1989), the only D.C. case specifically addressing the blue pencil rule, the Court of Appeals upheld the decision of a lower court enforcing only a portion of a restrictive covenant. Rather than specifically adopting the blue pencil rule, however, the Court found that the enforceable and unenforceable portions of the restrictive covenant were severable according to the terms of the contract. Future application of the blue pencil rule in D.C., if any, is therefore highly uncertain.

4. South Carolina Appears to Reject Blue Penciling

In *Poynter Invs. v. Century Builders*, 694 S.E.2d 15 (S.C. 2010), the Court reversed a lower court holding enforcing a non-compete after it had "blue penciled" the agreement's overly-broad provisions. The *Poynter* decision appears to reject "blue penciling" in general, even though earlier decisions had suggested a willingness to "blue pencil" and a federal district court decision, applying South Carolina law, had permitted blue penciling.

5. Blue Penciling in Canada

The Canadian Supreme Court, in rejecting the "blue pencil" doctrine in *Shafron v. KRG Ins. Brokers (W.) Inc.*, [2009] 1 S.C.R. 157, 2009 SCC 6 (Can.) stated as follows:

> Notional severance, reading down a contractual provision so as to make it legal and enforceable, is not an appropriate mechanism to cure a defective restrictive covenant. Notional severance may be available where an objective bright line test exists to distinguish what is legal from what is not. There is no objective bright-line test for reasonableness and applying notional severance simply amounts to a court rewriting a covenant in a manner that it subjectively considers reasonable. Employers should not be invited to draft overly broad restrictive covenants with the prospect

> that the court will sever the unreasonable parts or read down the covenant to what the courts consider reasonable. This would change the risks assumed by the parties and inappropriately increase the risk that an employee will be forced to abide by an unreasonable covenant. The Court of Appeal should not have attempted to resolve the ambiguity in this case by reading down the restrictive covenant according to its own notion of reasonableness and what it thought that the parties might have intended.
>
> Blue-pencil severance, removing part of a contractual provision, may be resorted to sparingly and only in cases where the part being removed is clearly severable, trivial and not part of the main purport of the restrictive covenant. Blue-pencil severance cannot be applied to remove the word "Metropolitan" from the restrictive covenant in this case because it is not merely a trivial part of the covenant agreed to by the parties. There is no evidence that the parties unquestioningly would have agreed to remove the word "Metropolitan" without varying any other terms of the contract or otherwise changing the bargain.

6. Unenforceable Portions of a Non-Compete Agreement May Be Severable

In *Star Direct, Inc. v. Eugene Dal Pra*, 767 N.W.2d 898, (Wis. 2009), the Supreme Court of Wisconsin, while noting that "[r]estrictive covenants in Wisconsin are prima facie suspect as restraints of trade that are disfavored at law", "must withstand close scrutiny", and "are not to be construed to extend beyond their proper import or father than the contract language absolutely requires" nevertheless allowed unenforceable portions of a covenant not to compete to be severed while enforcing the rest. *Id.* at 904-905. Despite Wisconsin's nominal prohibition – via statute – on "blue-penciling", the Court held that, there is no rule that all restrictive covenants are indivisible. The Court went on to explain that the "foundational inquiry for determining whether a covenant is divisible is whether, if the unreasonable portion is stricken, the other provision or provisions may be understood and independently enforced." This inquiry is fact intensive.

Accordingly, it appears that, with careful drafting, covenants not to compete will generally be divisible in most important ways, perhaps permitting back-door "blue-penciling" of covenants.

b. <u>When Will "Red Penciling" Be Required?</u>

Red penciling, now falling into disuse, is the practice of striking down the entire contract if any portion of it is invalid. This was the approach taken by the South Carolina Court of Appeals in *Faces Boutique, Ltd. v. Gibbs*, 455 S.E.2d 707 (S.C. Ct. App. 1995). Noting that "[c]ovenants not to compete contained in employment contracts are generally disfavored and will be strictly construed against the employer" the court explained that such covenants will be upheld only if it is:

1) Necessary for the protection of the legitimate interest of the employer;
2) Reasonably limited in its operation with respect to time and place;
3) Not unduly harsh and oppressive in curtailing the legitimate efforts of the employee to earn a livelihood;
4) Reasonable from the standpoint of sound public policy; and
5) Supported by valuable consideration.

The court went on to hold that if the covenant is deficient in any of the above areas, then it "cannot be saved" and must be stricken in its entirety. The court went on to affirm the trial court's decision to void the covenant for overbreadth.

Similarly, in *CAE Vanguard, Inc. v. Newman*, 518 N.W.2d 652 (Neb. 1994), the Supreme Court of Nebraska noted that "[t]his court has never allowed reformation of a covenant not to compete." *Id.* at 337. Declining to adopt the "majority rule" allowing blue-penciling, the court explained that "[t]his court has stated repeatedly that courts may not rewrite a contract for parties." After so holding, the court determined that "we must either enforce [the covenant not to compete] as written or not enforce it at all." Finding that the covenant was unenforceable as written, the court affirmed the trial court's decision. *See also Drumheller v. Drumheller Bag & Supply, Inc.*, 420 S.E.2d 331 (Ga. 1992); *Roy's Orthopedic, Inc. v. Lavigne*, 487 A.2d 173 (Vt. 1985).

XIV. ASSIGNMENT OF COVENANTS NOT TO COMPETE

a. <u>Assignability of Covenants not to Compete</u>

The majority rule is that restrictive covenants are not assignable. In some states, this is because covenants not to compete are held to be "personal to the parties" and therefore non-assignable. *See, e.g. Sisco v. Empiregas, Inc.*, 237 So. 2d 463 (Ala. 1970); *Smith, Bell & Hauck, Inc. v. Cullins*, 183 A.2d 528 (Vt. 1962). Other jurisdictions have concluded that employment contracts involve "personal services", and view assignment with the same disfavor that assignment of any contract for personal services is viewed. *See, e.g.*, *Trinity Transport v. Ryan*, 1986 Del. Ch. LEXIS 468 (Del. Ch. 1986); *Johnston v. Dockside Fueling of N.A.*, 658 So. 2d 618 (Fla. D.C.A. 3d 1995); *SDL Enterps., Inc. v. DeReamer*, 683 N.E.2d 1347 (Ind. Ct. App. 1997); *Avenue Z Wet Was Laundry Co. v. Yarmush*, 129 Misc. 427 (N.Y. Sup. Ct. 1927); *Mid-West Presort Mailing Serv. v. Clark*, 1988 Ohio App. LEXIS 615 (Ohio App. 1988); *Reynolds & Reynolds Co. v. Hardee*, 932 F. Supp. 149 (E.D. Va. 1996), *aff'd*, 133 F.3d 916 (4th Cir. 1997).

Some courts, however, have allowed assignment in the same manner of any other contract, barring the existence of a clause prohibiting assignment. *See*, *e.g.*, *Bradford & Carson v. Montgomery Furniture Co.*, 92 S.W. 1104 (Tenn. 1906); *Fink & Sons, Inc. v. Goldberg*, 139 A. 408 (N.J. Ch. 1927).

Covenants for personal services may nevertheless be assignable if the parties to the contract have consented to the assignment in the underlying contract. *See, e.g., Campbell v. Millenium Ventures,* 55 P.3d 429 (N.M. App. 2002); *Saliterman v. Finney*, 361 N.W.2d 175 (Minn. Ct. App. 1985); *Orkin Exterminating Co. v. Burnett*, 146 N.W.2d 320 (Iowa 1966); *Pino v. Spanish Broad. Sys., Inc.*, 564 So. 2d 186 (Fla. App. 1990); *Peters v. Davidson, Inc.*, 359 N.E. 2d 556 (Ind. App. 1977); *Mail-Well Envelopes Co. v. Saley,* 497 P.2d 364 (Or. 1972); *All-Pak v. Johnston*, 694 A.2d 347 (Pa. Super. 1997).

b. Is an Assignment Always Necessary to Transfer a Non-Compete to a New Employer?

If the sale is a stock sale, then the new employer is the successor, and there is no need for an assignment of the non-compete. *See, e.g., Corporate Express Offics Prods. V. Phillips*, 847 So. 2d 406 (Fla. 2003). On the other hand, if it is a sale of assets, then an assignment is necessary, and an assignment of a restrictive employment covenant is invalid without the assent of employee-assignee. *See, e.g. Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412 (3d Cir. 2010). In *Zambelli* the company's stock had been sold and there was no specific assignment of the employee's non-compete to the buyer of the stock, the issue thus being the impact of a stock sale on the enforceability of a non-compete agreement. The Court held "that the transfer of some or all of the stock of a corporation has no effect on its ability to enforce a non-compete agreement." The Court reasoned that "a stock sale, unlike a sale of assets, does not necessitate an assignment in order for the corporation to enforce an employment agreement" and "the transfer of a corporation's stock does not destroy the corporate entity" because its existence is "irrespective of, and entirely distinct from, the person who owns its stock". *See also Hess v. Gebhard & Co.*, 808 A.2d 912 (Pa. 2002) (finding that assignment must be made if the transaction is for a sale of assets); *Siemens Med. Sols. Health Servs. Corp. v. Carmelengo*, 167 F. Supp. 2d 752 (E.D. Pa. 2001) (concluding that a stock sale, unlike a sale of assets, did not require assignment of non-compete agreements for them to be enforceable).

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- *Automed Techs., Inc. v. Eller*, 160 F. Supp. 2d 915, 924 (N.D. Ill. 2001);
- *Hexacomb Corp. v. GTW Enter.*, 875 F. Supp. 457, 464 (N.D. Ill. 1993);
- *Hess v. Gebhard & Co. Inc.*, 808 A.2d 912, 917 (Pa. 2002);

Clark Substations, LLC v. Ware, 838 So.2d 360 (Ala. 2002).

c. Due Diligence During an Acquisition

In *OfficeMax, Inc. v. Levesque*, 658 F.3d 94 (1st Cir. 2011), a complicated chain of acquisitions reinforces the importance of due diligence. Two employees (the defendants) originally worked for Company A beginning in the 1980s. In 1996, Company B acquired all of Company A's shares. Shortly before this acquisition, the two employees had signed a non-compete agreement with Company A, which specifically contemplated Company A's sale to Company B in exchange for $2,500. Shortly thereafter, Company B requested that they sign new non-compete agreements, which employees refused to do. In 2006, Company B merged with Plaintiff OfficeMax. OfficeMax requested that the employees sign new non-compete agreements, which employees refused to do.

The original non-compete agreement that the employees entered into provided that they would not compete "for a period of 12 months after termination of my employment with [Company A]". The key issue in OfficeMax's subsequent lawsuit was whether this 12-month period began to run from the date of their termination by OfficeMax or from the date of Company A's sale to Company B. Finding that the contract was unambiguous on the point that the 12-month period began to run from termination of employment with Company A, the Court affirmed the lower court's refusal to enter an injunction against the employees. Once again, this emphasizes the importance of careful drafting in non-compete agreements, as well as the importance of having all employees sign renewed non-compete agreements after a merger or other acquisition.

XV. FORFEITURE CLAUSES IN DEFERRED COMPENSATION ARRANGEMENTS TRIGGERED BY VIOLATION OF NON-COMPETE

In New York, the Courts recognize the so-called "employee choice" doctrine, which holds that an employee who chooses to resign and violate non-compete obligations can be deemed to have waived any legal right to deferred compensation, regardless of whether the non-compete is reasonable. *See, e.g.*, *Morris v. Schroder Capital Mgmt.*, 859 N.E.2d 503 (N.Y. 2006). The doctrine applies to prevent courts from examining the reasonableness of the forfeiture, so long as the employee made a "genuine knowing and voluntary choice" to forego the benefits by accepting work with a competitor. *Murphy v. Gutfreund*, 583 F. Supp. 957 (S.D.N.Y. 1984).

XVI. GARDEN LEAVE CLAUSES

In *Bear Stearns & Co., Inc. v. McCarron*, C.A. No. 08-0978BLS1 (Mass. Super. Ct. Mar. 5, 2008), the Court declined to enforce a "garden leave" clause, that is, a provision requiring departing employees to provided mandatory notice which permits employers to force the employees to take "garden leave" while being paid by the employer rather than immediately joining a competitor. The Court found the 90 day notice provision unenforceable "because it would be fundamentally unfair to the Defendants' private clients at Bear Stearns , who would be left with uncertainty as to whom would actually be servicing their needs. *See also*, *Bear Stearns & Co, Inc. v. Sharon*, 550 F. Supp. 2d 174 (D. Mass. April 4, 2008) (Court refused a preliminary injunction because the effect would be require the Defendant to continue an employment relationship against his will).

In other cases, courts have responded to legitimate employee concerns related to "garden leave" provisions. For example, in *SG Cowen Sec. Corp. v. Stix*, No. 00-civ-3662 (S.D.N.Y. May 23, 2000), defendant began to work for a competitor of plaintiff prior to the expiration of a 120 "garden leave" clause. While granting plaintiff's request for an injunction requiring defendant to leave his current employer and return to "work" for plaintiff for the remainder of the time period, the court was sympathetic to employee's concerns. In particular, the defendant-employee was concerned that plaintiff would "lock him out" to prevent him from maintaining his business contacts. To address this concern, the court ordered that plaintiff must, in addition to providing the agreed upon compensation and benefits, allow the defendant-employee "access to professional services such as e-mail and voice mail that he may reasonably need to…stay abreast of professional developments in his areas of expertise." *See also* John Fellas, *Garden Leave: A New Weapon Against a Departing Employee,* N.Y.L.J., May 29, 1997.

XVII. DETERMINING DAMAGES FOR VIOLATION

a. In General

In *Saks Fifth Avenue, Inc. v. James, Ltd.*, 630 S.E.2d 304 (Va. 2006) the Virginia Supreme Court held a plaintiff must prove two primary factors when calculating damages caused by violation of a non-compete agreement. First, the plaintiff must establish a connection between the wrongful act and the damages. Secondly, plaintiff must prove that these damages have a factual foundation and are properly calculated. In this case, the court held that damages resulting from a salesman's departure for his employer's competitor must be calculated based upon the loss of business due to the salesman employment with the competitor and not just the departure of the salesman. In proving damages, it is generally proper to exclude fixed overhead costs. *SHV Coal, Inc. v. Cont'l Grain Co.*, 545 A.2d 917 (Pa. Super. Ct. 1988).

In *Shields v. DeVries,* 422 P.2d 828 (Wash. 1967) the Supreme Court of Washington held that damages for breach of a restrictive covenant are measured by the value of the business lost to the plaintiff-employer. 422 P.2d at 831 (citing *Merager v. Turnbull*, 99 P.2d 434 (Wash. 1940)). The court noted that "no more than nominal damages can be predicated on the failure to keep a promise which, had it been kept, would not have benefited the plaintiff in any way." 422 P.2d at 831.

One common way courts determined damages in restrictive covenant cases is to multiply the profit margin of the plaintiff employer by the number of sales to former customers of the former employer made by the former employee. *Cherne Insus., Inc. v. Grounds & Assocs, Inc.,* 278 N.W. 2d 81 (Minn. 1979) (also nothing that violators "of a covenant not to complete may be required to account for [their] profits, and such illegal profits may properly measure the damages." 278 N.W.2d at 94-95)).

In *Edwin K. Williams & Co. v. Edwin K. Williams & Co. –East*, 542 F.2d 1053 (9th Cir. 1976), *cert. denied*, 443 U.S. 908 (1977) the Ninth Circuit held that damages "may be awarded on the basis of gross profits when the breach does not significantly reduce overhead." 542 F.2d at 1062 (citing *Buono Sales, Inc. v. Chrysler Motors Corp.*, 449 F.2d 715 (3d Cir. 1971); *see also Hannigan v. Sears, Roebuck & Co.*, 410 F.2d 285 (7th Cir. 1969), *cert. denied*, 396 U.S. 902 (1969); *Vitex Mfg. Corp. v. Caribtex Corp.*, 377 F.2d 795 (3d Cir. 1967); *Noland Co. v. Graver*

Tank & Mfg.Co., 301 F.2d 43 (4th Cir. 1962); *Cook Indus., Inc. v. Carlson*, 334 F. Supp. 809 (N.D. Miss. 1971).

In some states, total sales are deducted from fixed costs to determine lost profits. *D.W. Trowbridge Ford, Inc. v. Galyen*, 262 N.W.2d 442 (Neb. 1978); *Aiken Indus., Inc. v. Estate of Wilson*, 383 A.2d 808 (Pa. 1978), *cert. denied*, 439 U.S. 877, *modified by* 394 A.2d 497 (Pa. 1978).

Damages for violations of non-compete agreements may be claimed for loss of goodwill (*Equifax Servs. Inc. v. Hitz,* 1992 U.S. App. LEXIS 16557, No. 91-3109 (10th Cir. July 9, 1992), for the cost of training replacement employees (*Id*.), and for losses from the use of employer's confidential information and trade secrets (*Kforce, Inc. v. SUrrex Solutions Corp.*, 436 F.3d 981 (8th Cir. 2006)).

b. Liquidated Damages

In *Redden v. Liptau*, 2010 Va. Cir. LEXIS 32 (Va. Cir. Ct. Fairfax County Feb. 16, 2010) defendant-employee's non-compete restrictive covenant with plaintiff-employer prohibited defendant from "engaging in any business that was similar to [plaintiff] during [defendant's] employment," and from "soliciting or hiring [plaintiff's] employees for any outside enterprises." The covenant further provided that 15 percent of plaintiff's overall compensation was consideration for entering into the non-compete.

The court found that defendant breached the covenant not to compete when he started a side business similar to plaintiff's business; defendant also breached the agreement when he solicited an employee of plaintiff to work for his side business. For breaching his non-compete agreement, the court thus found defendant liable for 15 percent of his wages paid for his work for plaintiff, as the liquidated damages provision was valid because "the actual damages for violating the non-compete agreement would be uncertain and difficult to determine with exactness and because the Court finds that the foreseeable actual damages contemplated in the contract are not out of proportion to the probable loss."

However, liquidated damages clauses which are unreasonable or which constitute "penalties" will not be enforced. In *Willard Packaging Co., Inc. v. Javier*, 2006 Md. App. LEXIS 73 (Md. Ct. Spec. App. 2006), the Maryland Court of Special Appeals held that the language in a restrictive covenant's liquidated damages clause was not calculated based upon a reasonable expectation of damages and was designed to serve as a penalty. This, combined with the determination that the parties were of unequal bargaining power and would be fired if they did not immediately sign the agreement, led the court to award the employer only nominal damages in the amount of $1.

A similar result was reached in *AMG Nat'l Trust Bank v. Ries*, Nos. 06-cv-4337, 09-cv-3061, 2011 U.S. Dist. LEXIS 149130 (E.D. Pa. Dec. 28, 2011). In *AMG*, defendant moved for summary judgment asking, among other things, that the court find the liquidated damages clause in a restrictive covenant to which defendant was subject unenforceable. The clause provided for payment of ten times the most recent gross annual fee received from any client with regards to whom defendant violated his non-compete obligations. The court found that, as a matter of law, ten years of projected fees constituted an "unreasonably large and incredibly disproportionate estimate of the presumed actual damages caused by breaching a two-year restrictive covenant." The court opined that even a substantially lower multiple may well be unenforceable.

Some courts have held that the existence of a liquidated damages clause prohibits injunctive relief. *Termplan Arabi, Inc. v. Carollo,* 299 So. 2d 831 (La. Ct. App. 1974); *Beneficial Fin. Co. v. Aldridge*, 200 So. 2d 681 (La. Ct. App.), *cert. denied*, 203 So. 2d 556 (La. 1967); *Holloway v. Faw, Casson & Co.*, 552 A.2d (Md. Ct. Spec. App. 1989), *modified by* 572 A.2d 510 (1990). Others have held the existence of a liquidated damages clause is not a bar to injunctive relief. *Overholt Crop Ins. Sev. Co. v. Travis*, 941 F.2d 1361 (8th Cir. 1991); *Dixon v. Royal Cup, Inc.*, 386 So. 2d 481 (Ala. Civ. App. 1980); *Boulder Medical Center v. Moore*, 651 P.2d 464 (Colo. App. 1982); *McRand, Inc. v. Van Beelen*, 486 N.E.2d 1306 (Ill. App. 1985); *Bettinger v. Carl Berke Assocs., Inc.*, 314 A.2d 296 (Pa. 1974).

c. Breach of Fiduciary Duty & Other Damages

In some states, recovery from a breach of fiduciary duty is not limited to lost profits, but may include all compensation otherwise due to the party guilty of the breach. *Kassab v. Ragnar Benson, Inc.*, 254 F. Supp. 830 (W.D. Pa. 1966). Pennsylvania courts, following the Restatement (SECOND) Agency § 469 (1958) employ the following rule:

> An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a willful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned.

In *Kassab*, a corporate officer was held to have forfeited an unpaid commission by disloyalty. In *Janssens v. Freedom Med., Inc.*, No. 10-2042, 2011 U.S. Dist. LEXIS 46670 (D. Md. April 29, 2011), the court noted that this rule extended equally to permit an employer to obtain disgorgement of amounts previously paid to a fiduciary who is later found to have lapsed. *See also* Restatement (THIRD) Agency § 8.01 c. d(2) (2006) (providing that it is within a court's discretion to mandate the forfeiture of all compensation paid during a period of disloyalty).

XVIII. PENALIZING RATHER THAN PROHIBITING COMPETITION

In *Miran v. Merullo*, 75 Va. Cir. 111 (Va. Cir. Ct. City of Virginia Beach Mar. 10, 2008), the parties entered into an LLC agreement that contained a non-competition clause that "proscribe[d] the defendants from opening a similar facility, during the cooperative business relationship between the parties, without including the plaintiff, by use of a $15,000.00 penalty should such an event occur." When defendants opened their own, new, separate school, using plaintiff's name and likeness, plaintiff brought this action alleging violation of the agreement, of which defendants challenged the validity.

The court found the non-compete enforceable as "the clause [] does not contemplate any restriction after the parties' business relationship ends," but instead "imposes a penalty of $15,000.00, should the defendants decide to operate a similar business during their relationship." As such, the court concluded, the restriction was not "an unduly oppressive restraint on the future employment of the defendants."

XIX. INJUNCTIONS, SPECIFIC PERFORMANCE, AND TROS

a. Grant or Denial of Preliminary Injunction in Action to Enforce Non-Compete

In *Technology Partners, Inc. v. Hart*, 298 Fed. Appx. 238 (4th Cir. 2008), the Fourth Circuit reviewed a lower court's decision not to grant a preliminary injunction. In *Hart*, defendant-former employee's employment agreement with plaintiff-former employer contained a covenant not to compete for a one-year period following his termination, from accepting employment at a "Conflicting Organization" or "any firm or corporation engaged in venture or business substantially similar" to that of plaintiff. The covenant also precluded defendant from accepting employment with a competitor in geographical areas in which plaintiff had done business or was doing business at the time of defendant's termination.

When defendant resigned from plaintiff amidst his discussions with a competitor of plaintiff, plaintiff filed a motion for preliminary injunction to prevent defendant from working for said competitor. The federal district court denied plaintiff's preliminary injunction, which plaintiff appealed.

The Fourth Circuit found that the district court, had properly applied the three-step analysis in *Blackwelder Furniture Co. of Statesville, Inc. v. Seilig Mfg. Co., Inc.*, 550 F.2d 189 (4th Cir. 1977), and had not abused its discretion in denying plaintiff's motion for a preliminary injunction.

Under *Blackwelder*, to adjudge the propriety of a grant or denial of a preliminary injunction, the court must (1) "balance the likelihood of irreparable harm to the plaintiff [if the injunction is denied] against the likelihood of harm to the defendant [if the injunction is granted]"; (2) determine whether the plaintiff is likely to succeed on the merits; and (3) determine where the "public interest lies with regard to the grant or denial of the preliminary injunction." In applying the third factor, the lower court noted that "it is a matter of public interest to see that non-compete agreements that are likely invalid do not receive the extraordinary relief of a preliminary injunction."

Finally, the loss of employees trained by the employer who in turn, had developed customer relationships can constitute a loss of unquantifiable assets capable of satisfying the irreparable harm requirements for a preliminary injunction. *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465 (S.D.N.Y. 2001); *Production Resource Group, L.L.C. v. Oberman*, 2003 U.S. Dist. Lexis 27898, 2003 WL 22350939 (S.D.N.Y. 2003); *Geritrex Corp. v. Dermarite Indus., LLC*, 910 F. Supp. 955 (S.D.N.Y. 1996).

It is worth noting regarding the grant of injunctions, temporary restraining orders, and similar relief which requires a showing of irreparable harm, that a short delay in seeking the relief does not weigh against a finding of irreparable harm if there was good reason for the delay. *Weight Watchers, Int'l, Inc. v. Lugino's Inc.*, 423 F.3d 137, 144-45 (2d Cir. 2005); *Compare to Int'l Creative Management, Inc. v. Abate*, 2007 WL 950092 at *3; 2007 U.S. Dist. LEXIS 22964 at *11 (S.D.N.Y. March 28, 2007) (finding literary agent's contracts to represent clients for specific projects only were not the kind of significant long-term client relationships that merited the protection of a restrictive covenant).

b. <u>Specific Performance and TROs: Balancing Irreparable Harm</u>

Courts will generally find irreparable harm where monetary relief would not adequately compensate the movant for the damages it is likely to suffer. *Hughes Network Sys., Inc. v. InterDigital Commc'ns Corp.*, 17 F.3d 691 (4th Cir. 1994). In the context of an action seeking specific enforcement of a restrictive covenant, irreparable harm exists "[w]hen the failure to grant preliminary relief creates the possibility of permanent loss of customers to a competitor or the loss of goodwill[.]" *Wachovia Ins. Serv., Inc. v. Hinds*, No. WDQ-07-2114, 2007 U.S. Dist. LEXIS 82103 (D. Md. Aug. 30, 2007). For example, in *Gen'l Parts Distrib., LLC v. St. Clair*, No. 11-cv-03556, 2011 U.S. Dist. LEXIS 145055 (D. Md. Dec. 14, 2011), the court found that irreparable harm existed when plaintiff demonstrated the probability that it would lose customers absent injunctive relief. In fact, the loss of client relationships and customer goodwill that results from the breach of a non-compete clause generally constitutes irreparable injury. *Johnson Controls, Inc. v. A.P.T. Critical Systems, Inc.*, 323 F. Supp. 2d 525, 532 (S.D.N.Y. 2004) (collects cases).

In *Howard Venture LLC v. Lively*, No. Civ. 10-4072, 2010 U.S. Dist. LEXIS 62336 (D.S.D. June 23, 2010), the former CEO of a South Dakota processor and seller of organic beef products had signed an employment agreement prohibiting him for two years after his employment terminated from disclosing confidential information, soliciting the Company's customers, and competing in the organic beef industry, anywhere that the Company conducted business. After the CEO was fired, he began competing against the Company and the Company filed suit, seeking a TRO. The federal district court entered a TRO, holding that "In competing against Dakota Beef and soliciting its customers it is likely that Lively will either intentionally or unintentionally disclose [Dakota Beef's] confidential information." While the Court recognized that the TRO could cause greater injury to Lively's new business than denial of the TRO might damage Dakota Beef's established business, the Court concluded that the irreparable harm to Dakota Beef's "competitive place in the organic beef marketplace" by disclosure of its confidential information tipped the balance in favor of granting the TRO.

c. <u>Effect of Bankruptcy Automatic Stay on Non-Compete Litigation Seeking Injunction</u>

In *In re Stone Res., Inc.*, 458 B.R. 823 (E.D. Pa. Bankr. 2011) the court found that an injunction enforcing a non-compete provision in a franchise agreement was not a "claim" against the bankruptcy estate under 11 U.S.C. § 101(12), since the injunction was a form of equitable relief for which an award of damages was not a viable alternative, and, thus, the injunction was not subject to the automatic stay.

d. Period of Injunction

Courts are split as to when the period for the injunction granted for the breach of a non-compete agreement begins. Some hold that the injunction period begins at the date of the employee's termination. *Gaylord Broadcasting Co. v. Cosmos Broadcasting Corp.*, 746 F.2d 251 (5th Cir. 1984) (applying Louisiana law)); *A—Copy Inc. v. Michaelson*, 599 F.2d 450 (1st Cir. 1978) (applying Massachusetts law); *Meeker v. Stuart*, 188 F. Supp. 272 (D.D.C. 1960), *aff'd*, 289 F.2d 902 (D.C. Cir. 1961); *De Long Corp. v. Lucas*, 176 F. Supp. 104 (S.D.N.Y. 1959), *aff'd*, 278 F.2d 804 (2d Cir. 1961), *cert. denied*, 364 U.S. 833 (1960); *Coffee Sys. Of Atlanta v. Fox*, 182 S.E.2d 109 (Ga. 1971); *Hayes v. Altman*, 266 A.2d 269 (Pa. 1970); *Edelman Realty v. Edelman*, 75 N.W.2d 29 (Mich. 1956); *Sherman v. Pfefferkorn*, 135 N.E. 568 (Mass. 1922); *Davis v. Buckingham*, 421 A.2d 427 (Pa. Super. 1980); *Elcor Chem. Corp. v. Agri-Sul Inc.*, 494 S.W.2d 204 (Tex. Ct. App. 1973); *Abalene Pest Control, Inc. v. Hall*, 220 A.2d 717 (Vt. 1966); *Alexander & Alexander, Inc. v. Wohlman*, 578 P.2d 530 (Wash. App. 1978). Other courts hold it begins on the date the injunction is issued. *Premier Indus. Corp. v. Texas Indus. Fastener Co.*, 450 F.2d 444 (5th Cir. 1971); *LCI Communications, Inc. v. Wilson*, 700 F. Supp. 1390 (W.D. Pa. 1988); *Roanoke Eng'g Sales Co. v. Rosenbaum*, 290 S.E.2d 882 (Va. 1982); *Cherne Indus., Inc. v. Grounds & Assocs., Inc.*, 278 N.W.2d 81 (Minn. 1979); *Capelouto v. Orkin Exterminating Co. of Fla.*, 183 So. 2d 532 (Fla. 1966), *appeal dismissed*, 385 U.S. 11 (1966).

In Indiana, where a non-compete has expired, the court will only grant injunctive relief if there are special or extenuating circumstances. *F.W. Means & Co. v. Carstens*, 428 N.E.2d 251 (Ind. Ct. App. 1981). Restrictive covenants may provide that the non-competition period does not run during any period during which the employee is in violation of the restrict covenant. Texas courts are split as to whether such provisions are enforceable. *Compare Aarow Chem Corp. v. Pugh*, 490 S.W.2d 628 (Tex. Civ App. 1972) (holding that such covenants are enforceable) *with Cardinal Personnel Inc. v. Schneider*, 544 S.W.2d 845 (Tex. Ct. App. 1978) (holding that such covenants are unenforceable).

e. Springboard Injunctions in the UK

A "springboard" in junction in the UK is an injunction which is not based in contractual restrictions to which an employee is subject, but which is instead imposed by the court in equity to prevent the employee from benefitting from their own wrongdoing. Originally conceived of as a means of prohibiting employees from benefiting from the misuse of confidential information when a contract remedy was insufficient or unavailable, the action has recently been expanded beyond these limits in *UBS v. Vestra*, [2008] EWHC 1974 (QB) (Q.B. 2008). In *UBS*, the court enjoined employees from dealing with the clients of their former employer for wrongfully initiating a scheme to solicit said clients to join a new firm that he was starting.

XX. UNCLEAN HANDS DOCTRINE / BREACH BY PLAINTIFF

a. Unclean Hands Doctrine

In *H&R Block Fin. Advisors, Inc. v. Majkowski*, 410 F. Supp. 2d 1 (D.D.C. 2006), Judge Robertson denied plaintiff's request for an extension of a preliminary injunction entered by the court. In *H&R Block*, the defendants appear to have planned to leave at a time during which they could take maximum advantage of the disruption their departure would cause in order to solicit clients from their former employer and otherwise compete in violation of non-compete agreements they had signed. Noting that these agreements would have required one defendant to "disappear from the face of the earth" should he resign, and that the hard-ball tactics employed by defendants reflected "behavior that to some extent was learned in [plaintiff's] own school" the court refused to extend the injunction. Noting that both plaintiffs and defendants were in a competitive industry in which "[defendants] and their employers live by the sword and die by the sword" the court was persuaded not to enter an injunction because "[plaintiff's] standard operating procedure…encourages just the kind of behavior about which [it] is now complaining."

b. Breach By Employer May Make Non-Compete Unenforceable

In *Francorp, Inc. v. Siebert*, 126 F. Supp. 2d 543 (N.D. Ill. 2000), the court refused to enforce a non-compete in the face of a material breach by the employer of the employment contract in which it was contained. Where the plaintiff-employer failed to pay employees in a timely fashion, said failure constitute a material breach of the employment relationship and accordingly the employer could not enforce the restrictive covenants against the former employees. The court based its holding on the general principle that a material breach of contract by one party excuses non-performance on the part of the non-breaching party. *But see Cohoon v. Fin. Plans & Strategies, Inc.*, 760 N.E.2d 190 (Ind. Ct. App. 2001) (enforcing non-compete despite material breach by employer where breach by employer occurred after employee's competitive activity); *Wichita Clinic v. Louis*, 185 P.3d 946 (Kan. Ct. App. 2008) (material breach did not prevent enforcement where employee had accepted the breach).

A similar, if more complex situation was presented in *Parr v. Alderwoods Group, Inc.*, 604 S.E.2d 431 (Va. 2004) when the Court was presented with four, allegedly integrated, agreements. In *Parr*, the Virginia Supreme Court affirmed in part and reversed in part the lower court's decision. Plaintiff lessee brought a claim against defendant lessor after the defendant began operating a funeral home in violation of a non-compete clause in the lease. The defendant argued that the plaintiff had violated one of the four agreements that had been signed contemporaneously with the lease, that the agreements were integrated, and therefore plaintiff's breach of one agreement rendered all the agreements void. The lower court found that the agreements were integrated, but enforced the restrictive covenant preventing defendant from operating a funeral home. The Supreme Court found that the lower court was correct in finding that the agreements were integrated, but found that the lower court erred in enforcing the restrictive covenant. The court held that plaintiff's breach of the agreements rendered the entire agreement void and therefore the restrictive covenants were not enforceable. *See also Laconia Clinic v. Cullen*, 408 A.2d 412 (N.H. 1979) (mismanagement of finances was a material breach of an employment agreement prohibiting enforcement of a non-compete).

XXI. JURISDICTIONS WHICH TEND TO BE HOSTILE TO NON-COMPETE AGREEMENTS

a. Virginia Supreme Court Reaffirms Hostility to Non-Compete Agreements

In *Home Paramount Pest Control Cos., Inc. v. Shaffer*, 718 S.E.2d 762 (Va. 2011), the Virginia Supreme Court was asked to rule on the validity of a non-compete agreement which prohibited the defendant former employee, for two years, from:

> Engage[ing] directly or indirectly or concern[ing] himself/herself in any manner whatsoever in the carrying on or conducting the business of exterminating, pest control, termite control and/or fumigation services as owner, agent…stockholder.

The Virginia Supreme Court affirmed the decision of the circuit court finding that this restriction was facially over-broad because it restricted defendant from working for any competitor, even in a capacity completely different from that in which he worked for his former employer. The Court further noted that, on its face, this language prohibited defendant from owning stock in a publicly traded company which owned a pest control business. The Court found that both these "sweeping prohibition[s]" exceeded plaintiff's legitimate business interests and unduly burdened defendant's right to earn a living.

In so doing, the Court upheld the lower court's ruling which required that "[w]hen a former employer seeks to prohibit its former employees from working for its competitors in any capacity, it must prove a legitimate business interest for doing so." In so holding, the Court overruled its opinion upholding the *exact same* non-compete in *Paramount Termite Control Co. v. Rector*, 380 S.E.2d 922 (1989), which suit was brought by plaintiff's predecessor.

b. Non-Compete Agreements Generally Void In India

In India section 27 of the Indian Contract Act, No. 1 of 1872; India Code (1993) applies to void almost all non-compete agreements:

> Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

This includes all non-compete agreements included in employment contracts. There is a narrow exception in the act which allows a reasonable non-compete clause to be included in a contract for the sale of a business. In *Percept D'Mark (p) Ltd. v. Zaheer Khan*, 2004 A.I.R. 362 (Bombay H.C.), the court found that a restrictive covenant may be enforceable to the extent that it does not extend beyond the term of a contract. In the case of employment contracts, this means that an employee may be subject to an enforceable non-compete agreement during his employment.

XXII. CHOICE OF LAW AND CHOICE OF FORUM CLAUSES

a. Choice-of-Law Clauses According to the Restatement (Second) of Conflicts of Law

Under the Restatement (Second) of Conflicts of Law, § 187, a choice-of-law clause is presumptively valid but can be overturned if the application of the chosen forum would violate a fundamental public policy of the state where the litigation is pending. *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990). *See also Movie Gallery US, LLC v. Greenshields*, 648 F. Supp. 2d 1252, 1270 (M.D. Ala. 2009).

b. Arizona Court Refuses to Apply Washington State Choice-of-Law Clause

In *Pathway Med. Techs., Inc. v. Nelson,* 2011 U.S. Dist. LEXIS 113075, (D. Ariz. Sept. 30, 2011), the federal district court refused to apply a Washington state choice-of-law provision, holding that Arizona had a greater interest than Washington in the case as Arizona's "fundamental policy" was at variance with the law of Washington state. For example, Arizona jurisprudence rejects "blue penciling" to reform an unreasonable clause; whereas Washington state permits "blue penciling."

c. Texas Supreme Court Upholds Florida Forum Selection Clause

In *In re AutoNation, Inc.*, 228 S.W.3d 663 (Tex. 2007), the Supreme Court of Texas was faced with a one year covenant not to compete which contained a choice of law provision and forum selection clause designating Florida as the forum of choice. After being sued in Florida by his former employer, the employee filed suit for declaratory judgment in Texas, asking the court to declare that the non-compete clause was governed by Texas law. The trial court refused to dismiss the action, and entered an injunction barring the former employer from pursuing its Florida lawsuit. On appeal, the Supreme Court conditionally granted a writ of mandamus, directing that the trial court dismiss the lawsuit in favor of the first-filed Florida action. In so doing, the Court explained that "fundamental" Texas policy did not require that every employment dispute with a Texas resident be litigated by Texas, and that the forum selection clause was proper because it did not demonstrate fraud, over reaching, or result in an undue hardship.

d. Eastern District of Virginia Upholds Kentucky Choice of Law Provision

In *Senture, LLC v. Dietrich*, 575 F. Supp. 2d 724 (E.D. Va. Sept. 8, 2008), the court was confronted with two issues: (1) whether Kentucky law should be applied to the defendants' non-compete restrictive covenants, pursuant to the defendants' employment agreements' forum selection clauses; and (2) whether the non-compete provision was unduly broad in its geographic and temporal scope.

Defendants' employment agreements provided for Kentucky law to control under resulting disputes; defendants, however, argue that Virginia law should apply as (1) the employments agreements were "adhesion contracts," and therefore unreasonable under the circumstances; and (2) Kentucky law conflicted with the public policy of Virginia. Here, the court held that because the defendants failed to argue that plaintiff's choice of Kentucky law was unreasonable, and because defendants failed to cite to a relevant public policy of Virginia that prohibited the court from using Kentucky law, no rationale existed to reject the parties' choice of Kentucky law.

The court also found the non-compete language reasonable in both geographic and temporal scope, as follows: (1) "the fact that the employment agreement designates the entire United States as its geographic scope is not unreasonable assuming that [plaintiff] does in fact do business across the country"; and (2) "the Court finds that the non-compete clause's length of time of one year is reasonable," as "Kentucky courts consistently uphold agreements for one or two years . . . so long as there [are] no facts indicating that the duration [is] substantially longer than necessary to protect a company's ability to compete in a field." *See also MCS Servs. v. Coronel*, 2008 Md. Cir. Ct. LEXIS 3 (Md. Cir. Ct. Montgomery County Mar. 4, 2008).

e. <u>California Court of Appeal Refuses to Apply Maryland Choice-of-Law Clause</u>

In *Application Group, Inc. v. Hunter Group, Inc.*, 1998 Cal. App. LEXIS 144 (Cal. Ct. App. 1998), the Court of Appeal of California affirmed a lower court decision that California and not Maryland law applied to the validity of a covenant not to compete placed in employment contracts of the out-of-state defendant corporation's consultants, who also did not reside in California, where a California employer sought to recruit and hire these same consultants. The court held that the covenants could not be enforced against the plaintiff corporation that had hired the defendant's former consultant, who had been a resident of Maryland but was hired to work in California. Despite the fact that a Maryland choice-of-law clause was in the contract between the defendant and the consultant, the court held that California law applied, because the covenant would restrict competition in California, thereby invoking the state's interest I protecting its own employers and business opportunities therewith. California jurisprudence has shown that the policy against non-compete covenants in employment contracts is a "fundamental policy" of the state. Further, California's interests would be seriously impaired if Maryland law were to trump in this matter, whereas the defendant could not show evidence that the consultant in this case was performing "unique services" or would be able to "misuse trade secrets, routes, or lists of clients," the existence of which would show that Maryland's interest would be seriously impaired.

f. <u>Eleventh Circuit Applies Georgia Law Based on Sufficiency of Contacts and "First to File" Rationale</u>

In *Manuel v. Covergys Corp.*, 430 F.3d 1132 (11th Cir. 2005), the Eleventh Circuit, applied Georgia law despite "limited" contacts with Georgia. Finding that those contacts, though limited, were sufficient to establish jurisdiction, the Court explained that because plaintiff employee filed suit in Georgia before employer filed suit in Ohio, the court deferred to Georgia law under which the non-compete agreement was invalid and unenforceable. *But see Keener v. Covergys Corp.*, 342 F.3d 1264 (11th Cir. 2003) *aff'g in part* 205 F. Supp. 2d 1374 (S.D. Ga. 2002) (applying Georgia law) (holding that the district court properly ruled that Georgia law did not allow the enforcement of a non-compete provision. However, the 11th Circuit ruled that the district court could not declare the non-compete provision unenforceable in any other jurisdiction as Georgia can only decide what is in the best interests of its citizens inside the state boundaries.)

XXIII. JURISDICTION AND VENUE

a. Jurisdiction and Non-Compete Agreements

1. Subject Matter Jurisdiction

Federal jurisdiction is available when the parties are of diverse citizenship and the amount in controversy exceeds $75,000. Of particular difficulty in non-compete cases can be determining the amount in controversy. The Fourth Circuit applies the "either-viewpoint" rule to this problem. *Dixon v. Edwards*, 290 F.3d 699 (4th Cir. 2002); *Gonzalez v. Fairgale Props. Co.*, 241 F. Supp. 2d 512 (D. Md. 2002). Under the "either-viewpoint" rule, the amount in controversy requirement is satisfied if *either* the gain to the plaintiff *or* the cost to the defendant is greater than $75,000.

In *TEKSystems, Inc. v. Fletcher*, No. 10-1145, 2011 U.S. Dist. LEXIS 22227 (D. Md. Mar. 2, 2011) court addressed the question of whether the amount in controversy exceeded $75,000 in plaintiff's action to enforce a restrictive covenant. In that case defendant successfully argued that the threshold was not met when only four months remained on the term of the non-compete when the competitive activity began, and when plaintiff had failed to specifically allege the value of its confidential information or that it had been disclosed by defendant in a way that profited him or damaged plaintiff. *See also Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

2. Personal Jurisdiction

Courts apply the factors set forth in *Consulting Eng'rs Corp. v. Geometric Ltd.*, 561 F.3d 273 (4th Cir. 2009) when determining whether personal jurisdiction exists over a defendant in a case alleging breach of a non-compete agreement. *See Laureate Educ., Inc. v. Megahed*, No. AW-10-749, 2010 U.S. Dist. LEXIS 65709 (D. Md. July 1, 2010). The *Consulting Engineers* factors are

1) The extent to which the defendant purposefully availed itself of the privilege of conducting activities in the State;
2) Whether the plaintiffs' claims arise out of those activities directed at the State; and
3) Whether the exercise of personal jurisdiction would be constitutionally reasonable.

In *Laureate Education*, the court addressed a motion by defendant-former employee Ms. Nivine Megahed for lack of personal jurisdiction. Megahed argued that she primarily performed her job responsibilities in Chicago, does not maintain an office or own property in Maryland, and that she did not deliberately attempt to initiate business in Maryland by seeking employment with a non-Maryland company which was later purchased by a Maryland company (plaintiff). Nevertheless, the court found that, on the balance, the *Consulting Engineers* factors weighed in favor of exercising jurisdiction, explaining that defendant continued to work for the Maryland employer after it had purchased the non-Maryland company defendant initially worked for, that defendant had engaged in regular meetings with staff in Maryland. The court noted that a defendant "need not physically enter the forum State" to make jurisdiction proper.

Similarly, in *CIENA Corp. v. Jarrard*, 203 F.3d 312 (4th Cir. 2000), the Fourth Circuit found that personal jurisdiction existed in an action to enforce a non-compete agreement against an out-of-state employee. In *Ciena Corp.*, the defendant had regularly traveled to Maryland in furtherance of her employment, had signed the agreement in Maryland, and had acquired confidential information while in Maryland.

b. Venue Transfers

If the non-compete has a forum selection clause and/or a choice-of-law clause, and the matter is either already in federal court or can be removed to federal court, consider moving to dismiss for improper venue or, alternatively, to transfer the case pursuant to 28 U.S.C. § 1404(a). In *Lane v. Nash Finch Co.*, No. 8:11-cv-241, 2011 U.S. Dist. LEXIS 110467 (D. Neb. Sept. 26, 2011), the employee filed in state court in Nebraska against his former employer, challenging the enforceability of a non-compete clause. The challenge included a challenge to the forum selection and choice-of-law clauses, each of which named Minnesota, where the employer was headquartered. The Defendant-employer removed to federal court on the basis of diversity, and then moved to dismiss for improper venue or, alternatively, to transfer to Minnesota. The federal district court granted the motion to transfer.

XXIV. STATE LEGISLATION REGULATING RESTRICTIVE EMPLOYMENT COVENANTS

Many states have existing legislation which regulates restrictive covenants, including:

- Alabama – Ala. Code § 8-1-1 (1984)
- California – Cal. Bus. & Prof. Code § § 16601-16602 (West 1987)
- Colorado – Colo. Rev. Stat. § 8-2-113 (1973)
- Florida – Fla. Stat. Ann. § 542.33 (West 1988)
- Georgia – Ga. Code Ann. § § 13-8-2 to 13-8-2.1 (1990)
- Hawaii – Haw. Rev. Stat. § 480-4 (1985)
- Louisiana – La. Rev. Stat. Ann. § 23:921 (West 1985)
- Massachusetts – Mass. Gen. Laws ch. 112, § § 12X, 74D (1984)
- Michigan – Mich. Comp. Laws Ann. § 445.774a (West 1990)
- Montana – Mont. Code Ann. § 28-2-703 (1989)
- North Carolina – N.C. Gen. Stat. § 75-2 (1988)
- North Dakota – N.D. Cent. Code § 9-08-66 (1987)

- Oklahoma – Okla. Stat. tit. 15, § § 217-219 (Supp. 1991)
- Oregon – Or. Rev. Stat. § 653.295 (1989)
- South Dakota – S.D. Codified Laws § § 53-9-8 to 53-9-11 (1990)
- Texas – Tex. Bus. & Com. Code § 15.05 (Vernon 1990)
- Wisconsin – Wis. Stat. Ann. § 103.465 (West 1988)

XXV. When Does a Non-Compete Clause Constitute Patent Misuse?

In *County Materials Corp. v. Allan Block Corp.,* 502 F.3d 730 (7th Cir. 2007), the Court rejected the claim that the non-compete clause constituted patent misuse. The Plaintiff had argued that the inclusion of the non-compete clause in the patent license was *per se* unlawful patent misuse and the improper result of patent leverage. The Court rejected such a *per se* rule, and instead applied the rule of reason, concluding that Plaintiff failed to show that the non-compete clause had any effect on the broader market for concrete blocks, rather than just impacting the Plaintiff.

XXVI. Employee's Duty of Loyalty and the "Key Employee" Doctrine

Wisconsin differentiates between so-called "key employees", whom it holds to have a duty of loyalty to their employer and other employees whom it concludes do not have such a duty. The "key employee" doctrine is a fact-intensive inquiry and a lower-level employee, depending upon facts and context, could be considered a "key employee". For example, in *Infocorp, LLC v. Hunt*, 780 N.W.2d 178 (Wis. Ct. App. 2009), Hunt, an at-will salesman contacted the sales manager of a direct competitor, indicating an interest in working for the competitor. After interviewing and accepting a job offer, but prior to his resignation, Hunt sought to divert specific sales to his new employer. The trial court held that Hunt, a salesman, not an officer or policymaker, owed no duty of loyalty to his employer. The Court of Appeals reversed, holding that the duty of loyalty is not so constricted. The Court of Appeals found the determining factor to be whether the alleged breach implicated the employee's specific job duties, finding that the employee acted directly contrary to his employer's interest in the course of performing his specific duties, and finding that to be sufficient to support a finding that the employee breached a duty of loyalty. The Court noted that Hunt, "while still employed by [Inforcorp] used his authority at [Inforcorp] to divert business [Infocorp] (by withholding customer orders until he joined [his new employer]), and to actively attempt to shift business from [Infocorp] to [his new employer]."

XXVII. Employee Choice Doctrine

While the enforcement of post-employment non-compete provisions is generally disfavored, New York and several other states adhere to an exception to this rule known as the "employee choice doctrine." Simply put, the employee choice doctrine exempts a post-employment non-compete provision from the usual reasonableness analysis where the non-compete is contingent on an employee's choice between receiving a benefit and competing with his or her employer.

In *Morris v. Schroder Capital Management*, 2006 N.Y. Ct. App. 859 N.E.2d 503 (N.Y. Ct. App. 2006) (The New York Courts recognize the "employee choice" doctrine which holds that an employee who chooses to resign and violate his/her non-competition obligations can be deemed to have waived any legal right to deferred compensation regardless of whether the non-competition agreement is reasonable. Under the "employee choice" doctrine, the deferred compensation plans provide that an employee who resigns and goes to work for a competitor automatically forfeits any non-vested deferred compensation).

The validity of this doctrine was affirmed by the Second Circuit in *Lucente v. Int'l Bus. Machines Corp.*, 310 F.3d 243 (2d Cir. 2002). In *Lucente*, the Second Circuit reaffirmed the doctrine and held that three standards govern its application:

1) The employer must demonstrate a continued willingness to employ the party who agreed not to compete;
2) The employer cannot invoke the doctrine when it involuntarily terminates an employee without cause; and
3) Whether an employee was involuntarily terminated is generally reserved for the jury.

Later, the New York Court of appeals – in response to a question certified to it by the Second Circuit – held that the doctrine could not be invoked against an employee who was constructively discharged. *Morris v. Schroder Capital Mgmt. Int'l,* 481 F.3d 86 (2d Cir. 2007).

In *IBM v. Bajorek*, 191 F.3d 1033 (9th Cir. 1999), the Ninth Circuit, although not directly addressing whether the contractual forfeiture clause in the contract before it was enforceable, held that it did not violate Cal. Bus. & Prof. Code § 16600. The court explained that the forfeiture provision did not constitute an impermissible limitation on business competition because "[i]t is one thing to tell a man that if he wants his pension, he cannot ever work in his trade again…and quite another to tell him that if he wants a million dollars from his stock options, he has to refrain from going to work for a competitor for six months." Noting the "limited scope of the restriction" the court found that it did not offend § 16600.

Of course, for the employee choice doctrine to apply, the employee must have had sufficient information to make a meaningful choice. For example, the federal district court for the southern district of New York refused to apply the employee choice in *Murphy v. Gutfreund*, 583 F. Supp. 957 (S.D.N.Y. 1984). In *Murphy*, the employee choice doctrine did not apply to prevent the employee from challenging the reasonableness of a non-compete clause in an annuity agreement because the employee was not apprised of the existence of the non-compete clause until after he had left his employer for a competing firm.

XXVIII. Common Law Claims and Non-Compete Agreements

In *Combined Ins. Co. of Am. v. Wiest*, 578 F. Supp. 2d 822 (W.D. Va. Aug. 11, 2008), plaintiff-employer asserted claims against defendant-former employee where defendant left employer to work for one of plaintiff's competitors. Specifically, plaintiff asserted claims for breach of employment contract non-compete provision, tortious interference with contractual relations and/or prospective business relations, breach of fiduciary duties, misappropriation of trade secrets, and conversion.

The court found the non-compete provision enforceable, as the restrictions applied only to the defendant's sales territory during the two-year period following defendant's employment, as opposed to plaintiff's entire market or any sales territory ever served by defendant.

Further, defendant argued that the tort claims for tortious interference, breach of fiduciary duty, and conversion should be dismissed, as the only duties allegedly breached by the defendant existed solely by virtue of the employment contract. Here the court held that these additional, non-contractual claims were viable under the common law and that Virginia courts have never intended to render the two causes of action mutually exclusive.

A valid non-compete or non-disclosure contract can provide grounds under Maryland law for a claim of tortious interference with that agreement against the future employer of an employee subject to those restrictions. *See, e.g., MCS Servs, Inc. v. Jones*, No. WMN-10-1042, 2010 U.S. Dist. LEXIS 105013 (D. Md. Oct. 1, 2010).

To establish a claim for tortious interference in Maryland, a party must be able to allege facts sufficient to show:

1) The existence of a contract;
2) Defendant's knowledge of that contract;
3) Defendant's intentional interference with that contract;
4) Breach of the contract; and
5) Resulting damages to plaintiff.

If the contract is invalid or unenforceable, then no claim for tortious interference will lie. *Id.* at *16-*17. Willingly accepting confidential information or prohibited services will satisfy requirements 3 and 4, above. *Id.* To establish damages, plaintiff need not be able to identify specific customers that it has lost if the court can plausibly infer from the facts alleged that plaintiff has suffered damages. *Id.*

Similarly, non-compete and non-disclosure agreements can support a claim for intentional interference with prospective advantage under Maryland law. To sustain such a cause of action, the claimant must be able to plead facts sufficient to show:

1) Intentional and willful acts
2) Calculated to cause damage to the plaintiff in its lawful business
3) Which are done with the unlawful purpose to cause such damage and loss, without right or justifiable cause on the part of defendants; and
4) Actual damages and loss resulting

Id. at *17-*18. The court in *MCS* found that plaintiffs sufficiently stated a claim when they alleged that defendant-former employee's new employer had hired him and accepted from him confidential trade secrets, which it then used to intimidate plaintiff's customers. The intimidation took the form of defendants "stating and/or implying that [defendant] would bring suit against certain of [plaintiff's] customers…unless [they] ceased doing business with [plaintiff]."

XXIX. DEFAMATION AS BREACH OF A RESTRICTIVE COVENANT

While not expressly ruling on this question, the court in *Severn Mktg. Assocs., Inc. v. Doolin*, No. CCB-09-3295, 2010 U.S. Dist. LEXIS 102992 (D. Md. Sept. 29, 2010) did hold open the possibility that defamation could, under certain circumstances, constitute a breach of an employee's non-compete agreement. In *Doolin*, plaintiff alleged that defendant had breached her restrictive covenant by "defaming [plaintiff] to its Principal…thereby interfering with Delmarva's relationship with that Principal." Although the non-compete did not contain an anti-defamation or non-disparagement clause, the court found that it did prohibit defendant from "directly or indirectly…interfer[ing] with or attempt[ing] to divert, sell or market for any Principal." Accordingly, the court refused to dismiss this count under Rule 12(b)(6), holding:

> If [plaintiff] succeeds in showing…that [plaintiff's] alleged defamatory comments 'interfer[d] with' [plaintiff's] relationship with [its clients] or 'divert[ed]' [clients] away from [plaintiff], those facts could establish that [defendant] breached the Employment Agreement, and [plaintiff] would be entitled to relief.

XXX. THE UNITED KINGDOM – DUTY TO DISCLOSE COMPETITIVE ACTIVITIES

In the United Kingdom, directors are subject to a duty, as part of his duty of loyalty, requiring them to disclose their own misconduct, including competitive activities which they have engaged in. *Item Software (UK) Ltd. v. Fassihi*, [2004] EWCA Civ. 1244 (Supreme Ct. of Judicature 2004), the Supreme Court of Judicature found that the defendant was subject to just such an obligation. The court noted that the very generality of the duty of loyalty is one of its strengths, explaining that it "is dynamic and capable of application in cases where it has not previously been applied but the principle or rationale of the rule applies." The court went on to note that "[t]he only reason that [the court] can see that it could be said that the duty of loyalty does not require a fiduciary to disclose his own misconduct is that it has never been applied to this situation before." Finding this rationale unpersuasive, the court applied the duty. In so doing, the court expressly noted the "open question" of whether such a duty applied to lower-level employees subject to the duty of loyalty.

This question, however, may be moot under the High Court's later decision in *Tullett Prebon v. BGC*, [2011] EWCA Civ. 131 (High Court of Justice 2011). In *Tullett*, the court found that employers may require employees to report to their employer any competitive activity, including their own, of which they become aware. This includes, for example, a duty to report approaches by competitors to hire the employee or other employees away. While it is unclear how broadly this decision is to be applied given the peculiar facts of *Tullett*, it at least holds open the prospect that a substantial number of employees at any given employer may be forced to turn in their co-workers for competitive activity by contract.

TRADE SECRETS

I. The Uniform Trade Secrets Act

As of March, 2012, forty-seven of the fifty states have adopted some form of the Uniform Trade Secrets Act (the "UTSA"), although there are often at least minor modifications to the statute. The states which have not yet adopted the UTSA in some form are Texas, New York, and Massachusetts.

I. Defining and Identifying "Trade Secrets"

a. Definition of "Trade Secret"

There is no one, uniform, definition of the type of information which can constitute a trade secret. For example, under the California Uniform Trade Secrets Act, Cal. Civ. Code § § 3426 *et seq.* a trade secret is defined as:

> [I]nformation, including a formula, pattern, compilation, program, device, method, technique, or process, that: (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and (2) I the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Cal. Civ. Code § 3426.1(d). While this definition is broad, it is not enough that a piece of information be labeled a trade secret. *See Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425 (Cal. Ct. App. 2003). Regardless of how it is labeled – or its precise form – almost any information can be a trade secret so long as it meets the pertinent test, including:

- Customer Lists: *Am. Family Mut. Ins. Co. v. Roth*, 485 F.3d 930 (7th Cir. 2007); *Liveware Publ'g, Inc. v. Best Software, Inc.*, 252 F. Supp. 2d 74 (D. Del. 2003); *Lamorte Burns & Co. v. Walters*, 167 N.J. 285 (N.J. 2001); *Ivy Mar. Co. v. C.R. Seasons, Ltd.*, 907 F. Supp. 547 (E.D.N.Y. 1995).
- Marketing, Sales, and Pricing Data and Analysis: *Union Carbide Corp. v. UGI Corp.*, 731 F.2d 1186 (5th Cir. 1984); *Johnson Controls, Inc. v. A.P.T. Critical Sys.*, 323 F. Supp. 2d 525 (S.D.N.Y. 2004); *Ikon Office Solutions, Inc. v. Am. Office Prods., Inc.*, 178 F. Supp. 2d 1154 (D. Or. 2001).
- Drawings or Product Specifications: *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113 (5th Cir. 1991); *Ctr. for Auto Safety v. Nat'l Highway Traffic Safety Admin.*, 93 F. Supp. 2d 1 (D.D.C. 2000).

- Chemical Formulae: *Kewanee Oil Co. v. Bicorn Corp.*, 416 U.S. 470 (1974); *Ctr. for Auto Safety v. Nat'l Highway traffic Safety Admin.*, 93 F. Supp. 2d 1 (D.D.C. 2000); *Wright Chem. Corp. v. Johnson*, 563 F. Supp. 501 (M.D. La. 1983).

b. Trade Secrets in Virginia and Maryland

Information is a trade secret under the Virginia Uniform Trade Secrets Act, Va. Code § 59.1-336 *et seq.*, and/or the Maryland Uniform Trade Secrets Act ("MUTSA"), Md. Code Ann., Com. Law §§ 11-1201 *et seq.*, only if two requirements are met: the information must (1) hold independent economic value because it is not generally known to or readily ascertainable by others who stand to benefit economically if they use or disclose it, and (2) be the subject of reasonable efforts to maintain its secrecy. *Dionne v. Southeast Foam Converting & Packaging, Inc.*, 240 Va. 297, 397 S.E. 2d 110, 113 (1990); *Lejeune v. Coin Acceptors, Inc.*, 381 Md. 288, 307, 849 A.2d 451, 462 (2004) (citing *Optic Graphics, Inc. v. Agee*, 87 Md. App. 770, 787, 591 A.2d 578, 587, *cert. denied*, 324 Md. 658, 598 A.2d 465 (1991)).

In *Shenandoah Studios of Stained Glass, Inc. v. Waters*, 27 Va. Cir. 464 (Warren Cty. Cir. Ct. 1983), the Court summarized the scope of enforceable trade secret protection as follows:

> This protection given to trade secrets is a shield, sanctioned by the courts, for the preservation of trust in confidential relationships; it is not a sword to be used by employers to retain employees by the threat of rendering them substantially unemployable in the field of their experience should they decide to resign.

Id. at 466 (quoting *E.W. Bliss Co. v. Struthers-Dunn, Inc.*, 408 F.2d 1108, 1112-13 (8th Cir. 1969)).

c. Must the Trade Secret be Identified with Specificity?

In *CMI Int'l, Inc. v. Intermet Int'l Corp.*, 649 N.W.2d 808 (Mich. Ct. App. 2002), the Michigan Court of Appeals addressed this question in the context of a lawsuit brought under the theory of inevitable disclosure. The facts were as follows: Plaintiff-auto parts manufacturer sued competitor and former chief technical officer for, *inter alia*, threatened misappropriation of trade secrets, relying on the inevitable disclosure concept. The court held that, assuming the concept was encompassed within the notion of "threatened misappropriation," the party must establish more than the existence of generalized trade secrets and a competitor's employment of the party's former employee who has knowledge of the trade secrets. Otherwise, the concept would compromise the right of employees to change jobs.

In *DeRubeis v. Witten Techs., Inc.*, 244 F.R.D. 676 (N.D. Ga. 2007), the court addressed this question in the context of discovery. Plaintiff-employee originally brought suit for breach of employment agreement, and defendant-employer counterclaimed for misappropriation of trade secrets. Defendant-employer then requested discovery which would have required plaintiff-employee to "identify its trade secrets at issue in this case with particularity." Plaintiffs sought a protective order delaying their obligation to respond to this request until such time as defendant "first described its alleged trade secrets with particularity." The issue before the court was whether the defendant-employer (the trade-secret plaintiff) was required to identify the trade secrets allegedly misappropriated before plaintiff-employees (the trade-secret defendants) are obligated to provide discovery.

Noting that "[t]rade secret cases present unique and difficult problems with respect to the timing and scope of discovery" (*citing* Kevin R. Casey, *Identification of Trade Secrets During Discovery: Timing and Specificity*, 24 AIPLA Q.J. 191 (1996)), the court explained that the facts presented here were "typical" of the problems presented. The common issue identified by the court is the belief, perhaps justified, by the employer that some portion of its trade secrets have been misappropriated by former employees, but an inability of the employer to identify those trade secrets with particularity in the absence of discovery. The court found that forcing the trade-secret plaintiff to identify its trade secrets before knowing which have been misappropriated places it in a "Catch-22" situation:

> Satisfying the requirement of detailed disclosure of the trade secrets without knowledge [of] what the defendant is doing can be very difficult. If the list is too general, it will encompass material that the defendant will be able to show cannot be trade secret. If instead it is too specific, it may miss what the defendant is doing.

Id. at 202 (quoting Lynn H. Pasahow, *Patent and Trade Secret Biotechnology Litigation*, 1993 Biotechnology: Business, Law, and Regulation 37, 52 (ALI-ABA Course Study Materials)).

In opposition to this concern, the court noted that straying too far in the other direction may tur trade secrets complaints into fishing expeditions. *See Ray v. Allied Chemical Corp.*, 34 F.R.D. 456 (S.D.N.Y. 1964). Furthermore, it is difficult to know what information is relevant, either to a discovery request or to a potential defense, until the trade secret has been specifically identified. Finally, plaintiff should not be permitted to "mold its cause of action around the discovery it receives." *See* Casey, 24 AIPLA Q.J. at 210-11; Jerome Doyle & Allen S. Joslyn, *The Role of Counsel in Litigation Involving Technologically Complex Trade Secrets*, 6 B.C. Indus. & Comm. L. Rev. 743 (1965).

Based on the complexities of the issues in this area, the court found that the "proper approach is clearly fact dependent." Casey, 24 AIPLA Q.J. at 241. Balancing the policy considerations in this case, the court found that it was appropriate to first require the trade-secret plaintiff to first identify with "reasonable particularity" those trade secrets believed to be at issue before becoming entitled to discovery.

In *L-3 Commc'ns Corp. v. Jaxon Eng'g Maint., Inc.*, No. 10-cv-02868, 2011 U.S. Dist. LEXIS 117757 (D. Col. Oct. 12, 2011), the court adopted a high bar with respect to the requirement that plaintiffs identify the alleged trade secret with particularity. As an initial matter, the court noted that "[t]here is no privilege excepting trade secrets from discovery", though courts should avoid unnecessary disclosure of such information. *Dura Global Techs., Inc. v. Magna Donnelly, Corp.*, No. 07-cv-10945, 2007 U.S. Dist. LEXIS 89650 (E.D. Mich. Dec. 6, 2007). The court noted that the "threshold" of particularity required in trade secrets cases serves several purposes, including putting defendant on notice of what it has allegedly misappropriated, avoiding disclosure by defendant of trade secrets which were not misappropriated to plaintiff, and preventing plaintiff from "molding" its cause of action around the discovery it receives. *See Sit-Up, Ltd. v. IAC/Interactive Corp.*, No. 05-cv-9292, 2008 U.S. Dist. LEXIS 12017 (S.D.N.Y. Feb. 20, 2008); *Gentex Corp. v. Sutter*, No. 3:07-cv-1269, 2008 U.S. Dist. LEXIS 96188 (M.D. Pa. Nov. 25, 2008); *DeRubeis v. Witten Techs., Inc.*, 244 F.R.D. 676 (N.D. Ga. 2007).

With these purposes in mind, and while recognizing that "the case law does not provide clear guidance as how detailed a plaintiff's trade secret disclosures must be[,]", the court found that "general allegations and generic references to products or information are insufficient to satisfy the reasonable particularity standard." In the instant case, the court found that plaintiff's disclosures were "mere general, categorical references to the equipment, methods, and software Plaintiffs use to conduct [certain operations]" and that "[t]hereafter, plaintiffs only generally allege that Defendants misappropriated their trade secret customer lists; pricing templates and labor rates; vendor lists; drawings, designs, and processes[.]" Explaining that "at no point…do Plaintiffs describe the actual equipment, methods, software or other information they claim as trade secrets", the court ordered production of such information. The court did leave open the possibility of such documents being filed under seal.

Similarly, in *Delphon Indus., LLC v. Int'l Test Solutions, Inc.*, No. 11-01338, 2012 U.S. Dist. LEXIS 659 (N.D. Cal. Jan. 4, 2012), the court held that "[w]hatever [plaintiff] wishes to claim as trade secrets that [defendant] misappropriated, it must identify each particular composition, formula, technology and manufacturing techniques, application and manufacture of [the product] without further delay." In *Delphon*, plaintiff brought suit against defendant for misappropriation of gels and polymers created using proprietary formulae. When defendant challenged plaintiff to specifically identify the trade secrets allegedly misappropriated, plaintiff replied that it "customizes the composition of its [products] to its customers' needs" and identified the trade secrets as "[t]he 'recipe' for its different [products] – including the amount of each ingredient used, the process…methods of combining the ingredients, the use of solvents with gel materials, and the blending, mixing, and dispersion of additives[.]"

The court found that this did not constitute a sufficiently specific identification of the trade secrets at issue. In so holding, the court noted that "the description is so general that [plaintiff] did not even bother to protect the description under the terms of the Stipulated Protective Order." Furthermore, plaintiff's technical witnesses admitted that the description was general, even though plaintiff possessed specific information regarding the identity of the trade secrets. Finally, the court found that plaintiff's description would not allow experts in the field "to review [plaintiff's] designations and distinguish the alleged trade secrets from information in the field." *See also Jardin v. DATAllegro*, No. 10-cv-2552, 2011 U.S. Dist. LEXIS 84509 (S.D. Cal. July 29, 2011) (also finding that plaintiff had not sufficiently identified the trade secrets which it alleged had been misappropriated).

d. California Courts Require Early Trade Secret Identification

In *N.A. Lubricants, Co. v. Terry*, 2011 U.S. Dist. LEXIS 133672 (E.D. Cal. Nov. 18, 2011), the court re-emphasized the obligation of a plaintiff in a trade secret case to identify the trade secret. The Court indicated that identification serves four primary purposes:

1) It promotes "well-investigated" claims and dissuades the filing of meritless trade secrets complaints;
2) It prevents plaintiffs from using the discovery process as a means to obtain the defendant's trade secrets;
3) It assists the Court in framing the appropriate scope of discovery and in determining whether plaintiff's discovery requests fall within that scope; and
4) It enables defendants to form complete and well-reasoned defenses, ensuring that they need not wait until the eve of trial to effectively defend against charges of trade secrets misappropriation.

The Court provided several examples of improperly identified trade secrets, including the following: (a) the plaintiff's "business model," (b) its "business plan," and (c) "marketing materials."

II. PRICING INFORMATION

In general, a company's non-published pricing information is a trade secret. *See PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995). However, this is not always the case as, for instance, when a company does not prohibit its customers from sharing its pricing information with other participants in the industry. In *Sw. Stainless, LP v. Sappington*, 582 F.3d 1176 (10th Cir. 2009), the Court found that when a company discloses its pricing information to its customers "without reservation" then that information does not qualify for protection as a trade secret. In *Southwest Stainless*, the court noted that plaintiff did take steps to keep its pricing information confidential, including requiring employees to sign confidentiality agreements, restricting access to company information, and spending substantial sums of money to collect its information. However, the court found that other practices engaged in by plaintiff, such as allowing certain customers to order based on monthly-updated "posted pricing", and allowing its customers to disclose pricing information to others vitiated the claim that its pricing information constituted a trade secret.

III. INDEPENDENT ECONOMIC VALUE REQUIREMENT

At least in California, a trade secret does not qualify for protection unless it has an economic value, derived from its secrecy, and that third parties can gain economic value from its disclosure or use. In *Yield Dyanmics, Inc. v. Tea Systems Corp.*, 154 Cal. App. 4th 547 (2007), the court found that, under Cal. Civ. Code § 3426.1(d)(1), the fact that a segment of computer code could provide "some help" to another programmer did not compel a finding that it had economic value absent evidence that it could provide an economic advantage over others. The court also held that taking steps to keep information secret, in and of themselves, do not establish that the thing kept secret has independent economic value. The court explained that an entity seeking to establish a claim under California's Uniform Trade Secrets Act must establish that the information identified as trade secrets must "in and of themselves…provide a competitive advantage to a competitor."

IV. CUSTOMER LISTS

a. Customer Lists Can Be Trade Secrets if Not Basic

In *AMG Nat'l Trust Bank v. Ries*, 2011 U.S. Dist. LEXIS 149128 (E.D. Pa. Dec. 29, 2011), the court rejected defendant's argument that customer lists could not be trade secrets. While noting that customer lists are "at the very periphery of the law of unfair competition" the court held that they may nevertheless qualify as trade secrets so long as they consist of more than a collection of basic, widely available information. An employer seeking protection for customer lists must show that the employee was able to collect the information contained therein only with the aid, assistance, and position provided by the employer.

The appellate division of the Supreme Court of New York reached a similar conclusion in *Amana Express Int'l, Inc. v. Pier-Air Int'l, Ltd.*, 211 A.D.2d 606 (N.Y. App. Div. 1995). In *Amana*, the court noted that "[s]olicitation of an employer's customers by a former employee is not actionable unless the customer list could be considered a trade secret or there was wrongful conduct by the employee such as physically taking or copying the employer's files or using confidential information." In particular, the court held that "trade secret protection will not attach to customer lists where such customers are readily ascertainable from sources outside the former employee's business unless the employee had stolen or memorized the customer lists."

b. Whether Customer Lists are Trade Secrets Turns On the Availability of the Information

In *Gill Group, Inc. v. Baker*, No. CCB-09-2945, 2010 U.S. Dist. LEXIS 76672 (D. Md. July 29, 2010), plaintiff-employer sued defendant-former employee for misappropriation of trade secrets for his use of contact information/customer lists acquired during his tenure with his former employer. The customer which plaintiff alleged he had contacted, however, was the U.S. Army. The contact information of the individuals which defendant had contacted was publicly available and, as the court explained "it is likely that anyone interested in bidding on [a particular contract] would contact the U.S. Army or Atlantic Marine and be put in touch with [the individuals defendant contacted]." The court went on to note that the "contracts at issue are government contracts subject to public competitive bidding" and that the price, more than personal relationships, would likely be determinative. *See Ecology Servs., Inc. v. Clym Envtl. Servs.*, 952 A.2d 999 (Md. Ct. Spec. App. 2008). Accordingly, the court found that the customer list in question was not a trade secret.

A similar result was reached by the federal district court for the District of Maryland in *Home Paramount Pest Control Cos. v. FMC Corp.*, 107 F. Supp. 2d 684 (D. Md. 2000). In *Home*

Paramount, the court held that a customer list did not constitute a trade secret. In so doing, the court placed particular emphasis on the fact that the customer information at issue was publicly available. By contrast, in *NaturaLawn of Am., Inc. v. W. Group, LLC*, 484 F. Supp. 2d 392 (D. Md. 2007), the identities of the customers were are carefully guarded secret. In that case, the court sided with plaintiff and found that the customer list was indeed a trade secret.

c. <u>Customer Lists Can Be Trade Secrets Even if Memorized</u>

Assuming that the customer list otherwise constitutes a trade secret, most courts do not require that the list physically exist outside of the employees mind. Both Ohio and Connecticut have recognized that memorized customer lists can form the basis for a trade secret violation. *See Al Minor & Assocs. v. Martin*, 117 Ohio St. 3d 58 (Ohio 2008); *Gen'l Reinsurance Corp. v. Arch Capital Group, Ltd.*, No. X05-cv-074011668S, 2007 Conn. Super. LEXIS 2629 (Conn. Super. Ct. Oct. 17, 2007); *See also Amana Express Int'l, Inc. v. Pier-Air Int'l, Ltd.*, 211 A.D.2d 606 (N.Y. App. Div. 1995) (noting that trade secret protection will not attach to customer lists "unless the employee had stolen or memorized the customer lists).

In *Al Minor & Assocs, Inc. v. Martin*, 117 Ohio St. 3d 58 (Ohio 2008), plaintiff, an actuarial firm, hired defendant without requiring him to sign a non-compete agreement. When defendant left plaintiff's employment, he successfully solicited 15 of plaintiff's clients using information that he had memorized. Plaintiff brought suit against defendant, alleging that he had violated Ohio's Uniform Trade Secrets Act. The Ohio Supreme Court found that Ohio's public policy favored the protection of trade secrets, regardless of their form, and that none of the sources reviewed by the Court indicated that a trade secret's protection was dependent on its form.

One key inquiry here is the precise manner in which the customer list was obtained. For example, in *Hayes-Albion v. Kuberski*, 364 N.W.2d 609 (Mich. 1985) the court refused to protect customer contact information. In that case, the court found no impropriety in an employee "establishing his own business and communicating with customers for whom he had formerly done work in his previous employment" so long as the employee "did not 'steal' a list of customers" which had been kept secret by the employer. *Id.* at 615. *See also Cruises of Distinction v. Northstar Cruises, Inc.*, No. 97-CV-74152-DT, 1999 U.S. Dist. LEXIS 8743 (E.D. Mich. May 20, 1999); *Orbach v. Merrill Lynch*, No. 93-CV-75349-DT, 1994 WL 900431 (E.D. Mich. Jan. 11, 1994) (both distinguishing between stolen lists and remembered information).

d. <u>Customer Lists as Trade Secrets in Maryland</u>

Maryland courts will extend trade secrets protection to customer lists based on a consideration of the following factors:

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 to [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.

See Bond v. PolyCycle, Inc., 732 A.2d 970, 973 (Md. Ct. Spec. App. 1999). This is settled law – there is "no question" that a customer list can – in appropriate circumstances – constitute a trade secret. *Home Paramount Pest Control Cos. v. FMC Corp.*, 107 F. Supp. 2d 684 (D. Md. 2000); *See also PADCO*, 179 F. Supp. 2d 600 (D. Md. 2002); *MCS Servs., Inc. v. Jones*, No. WMN-10-1042, 2010 U.S. Dist. LEXIS 105013 (D. Md. Oct. 1, 2010); *Gen'l Parrts Distrib., LLC v. St. Clair*, No. 11-cv-03556, 2011 U.S. Dist. LEXIS 145055 (D. Md. Dec. 14, 2011).

V. "TOTAL COMPILATION" OF A SOFTWARE PACKAGE AS A TRADE SECRET:

In *Decision Insights, Inc. v. Sentia Group, Inc.*, 416 Fed. Appx. 324 (4th Cir. 2011), Decision Insights ("DI") filed a complaint in June of 2006 against Sentia Group and its four founders, three of whom were previously affiliated with DI. Included in DI's complaint were claims that the defendants' development of a competing software application was based on materials obtained from the defendants' misappropriation of DI's trade secrets.

In June of 2007, the United States District Court for the Eastern District of Virginia granted the defendants' motion for summary judgment on all of DI's claims. In doing so, the District Court held that DI had not shown the existence of trade secrets or confidential information. In February of 2009, the Fourth Circuit affirmed the District Court's judgment in part and reversed it in part. *See Decision Insights, Inc. v. Sentia Group, Inc.*, 311 F. Appx. 586 (4th Cir. 2009) (per curiam). The Fourth Circuit agreed with the District Court's conclusion that DI's description of the 12 processes within the software was "incomplete and fragmented", and that DI therefore did not describe those individual processes adequately enough allow the Court to perform a meaningful evaluation of whether they constituted trade secrets when taken individually. However, the Fourth Circuit held that the District Court had erred by holding that DI had not shown, as a matter of law, that the software program as a "total compilation" was a trade secret. At the trial below, DI had produced the full source code of the software in question, as well as a flow chart and narrative explaining the way that its software worked as a whole. Thus, the Fourth Circuit remanded the case to the District Court to determine whether DI had adequately identified its software "compilation" as a trade secret, and if so, whether DI had established a triable issue of fact as to the existence of a trade secret in connection with that compilation.

On remand, the District Court again granted the defendants' motion for summary judgment, holding that DI had failed to develop facts during discovery that would establish that DI's software compilation is not generally known or ascertainable.

In March of 2011, the Fourth Circuit vacated the District Court's judgment, and remanded the case for further proceedings consistent with its opinion. In so doing, the Fourth Circuit held that DI adduced sufficient evidence during discovery to allow a jury to reach the ultimate conclusion that DI's software, as a compilation, was not generally known or ascertainable by proper means, within the meaning of the Virginia Trade Secret Misappropriations Act, Va. Code Ann. §§ 59.1-336 through 59.1-343.

VI. EMPLOYEE MEMORY

Historically, Courts have been reluctant to find that an employee's use of trade secrets which he memorized was unlawful. *Peerless Pattern Co.. v. Pictoral Review Co.*, 132 N.Y.S. 37 (N.Y. App. Div. 1911). And indeed, courts remain reluctant to interfere with knowledge obtained casually as part of an employee's regular job duties. *See Great Lakes Carbon Corp. v. Koch Indus., Inc.*, 497 F. Supp. 462 (S.D.N.Y. 1980); *Anchor Allows, Inc. v. Non-Ferrous Processing Corp.*, 39 A.D.2d 504 (2d Dep't 1972). On the other hand, use of information which is obtained in breach of fiduciary duty through, for example, theft, misappropriation, or other unauthorized means will likely be enjoined regardless of whether it technically constitutes a trade secret. *See Inflight Newspapers, Inc. v. Magazines In-Flight, LLC*, 990 F. Supp. 119 (E.D.N.Y. 1997); *Earthweb, Inc v. Schlack*, 71 F. Supp. 2d 299 (S.D.N.Y. 1999).

However, there is a growing trend away from this position. Several courts have enjoined the use of confidential information memorized by former employees. *See* Restatement (Third) Agency § 8.05, Comment *c*; 2 Louis Altman, Callmann on Unfair Competition, Trademarks and Monopolies § 14:25 (4th Ed. 2007).

VII. KNOWLEDGE ACQUIRED THROUGH EXPERIENCE

In the absence of fraud, courts have held that information and knowledge acquired by an employee during the course of years working in a particular trade or industry are not trade secrets. *See, e.g., Great Lakes Carbon Corp. v. Koch Indus., Inc.*, 497 F. Supp. 462 (S.D.N.Y. 1980); *Anchor Allows, Inc. v. Non-Ferrous Processing Corp.*, 39 A.D.2d 504 (2d Dep't 1972); *Gulf Oil Corp. v. Rapp*, 33 Misc. 2d 1011 (Sup. Ct. Kings Cnty 1962). This means that an employee's use of information gained passively or casually is not a violation. *Levine v. Bochner*, 132 A.D.2d 532 (2d Dep't 1987). Nevertheless, intentionally memorizing, copying, or otherwise taking actions with the intent of removing secrets from an employer – rather than simply making use of information acquired during the course of employment – remains actionable. *Lincoln Steel Prods., Inc. v. Schuster*, 49 A.D.2d 618 (2d Dep't 1975). Of course, this is not to say that an employee may not owe his or her former employer a fiduciary duty which may impinge on his or her ability to use such information. *See Nutronics Imaging, Inc. v. Danan*, No. cv 96-2950, 1998 WL 426570 (E.D.N.Y. Jun. 10, 1998); *Mallory Factor Inc. v. Schwartz*, 146 A.D.2d 465 (1st Dep't 1989).

VIII. HIRING A COMPETITOR'S EMPLOYEE

In *Nw. BEC-Corp. v. Home Living Serv.*, 41 P.3d 263 (Idaho 2002), the Court issued a strongly worded opinion on this subject. In this action, plaintiff-former employer sued former employee and her new employer for misappropriation of trade secrets. Defendants established that plaintiff's loss of 90 customers following former employee's departure was not a result of a misappropriation. In strong language, the court stated that the legislature did not intend that the mere hiring of a competitor's employee constitutes the acquisition of a trade secret. Further, the court said:

> "An employee will naturally take with her to a new company the skills, training, and knowledge she has acquired from her time with her previous employer. This basic transfer of information cannot be stopped, unless an employee is not allowed to pursue her livelihood by changing employers. As Judge Shadur stated, '[a]ny other rule would force a departing employee to perform a prefrontal lobotomy on himself or herself." *Fleming Sales Co., Inc. v. Bailey*, 611 F.Supp. 507, 514 (D.C.Ill. 1985)."

On a similar note, the Massachusetts Superior Court, applying California law in *Aware, Inc. v. Ramirez-Mireles*, 13 Mass. L. Rptr. 257 (Mass. Super. 2001), stated:

> "What is clear, however, is that in a conflict between the policy favoring employee mobility free of encumbering restriction and the policy favoring protection of trade secrets, employee mobility prevails in California. The theory of 'inevitable disclosure' of trade secrets is not the law of California. *See Bayer Corporation v. Roche Molecular System, Inc.*, 72 F.Supp.2d 1111, 1112 (N.D.Cal. 1999)."

IX. EMPLOYEE SOCIAL MEDIA ACCOUNTS

a. Twitter

In *PhoneDog v. Kravitz*, 2011 U.S. Dist. LEXIS 129229 (N.D. Cal. Nov. 8, 2011), plaintiff sued a former employee, alleging that the username, password, and "followers" of a twitter account created by the former employee constituted trade secrets within the meaning of the California Uniform Trade Secrets Act ("UTSA"), Cal. Civ. Code § 3426.1. The username and password had originally been provided to defendant by plaintiff. Defendant moved to dismiss for failure to state a claim, arguing that the followers of the account "have been publicly available for all to see at all times", and that the account password "do not derive any actual or potential independent economic value under the UTSA because they do not provide any substantial business advantage." Defendant further argued that he, not plaintiff, initially created the password, and that plaintiff did not make reasonable efforts to maintain its secrecy. The Court denied defendant's motion to dismiss for failure to state a claim, with regards to plaintiffs claims for misappropriation of trade secrets and conversion, holding simply that because plaintiff had sufficiently described the subject matter of the trade secret with particularity, and has alleged that plaintiff failed to relinquish the account's password, plaintiff had sufficiently stated a claim, and that defendant's additional challenges would await summary judgment. However, the court dismissed plaintiff's claims for intentional and negligent interference with prospective economic advantage, explaining that California law does not protect "potential" relationships which are "at most a hope for an economic relationship and a desire for a future benefit." Explaining that the "nature of PhoneDog's purported economic relationship" with the account's followers was unclear, the Court agreed with defendant that plaintiff had failed to allege actual disruption of any relationship or harm therefrom.

b. LinkedIn

An employer can claim ownership of an Executive's LinkedIn account that it required the Executive to open and maintain, according to the holding in *Eagle v. Morgan*, No. 11-4303, 2011 U.S. Dist. LEXIS 147247 (E.D. Pa. Dec. 22, 2011). In *Eagle*, the employer had required the executive to open the account, maintain it, use it to advertise the employer's credentials and services. The employer was also involved in the creation, operation, and monitoring of the account. The employer's victory on this point was not unequivocal, however. While the court refused to dismiss the employer's claim for "misappropriation of an idea" and unfair competition, it did dismiss the employer's claims for misappropriation of trade secrets and conversion. In dismissing the latter two causes of action, which were based around the executive's use of the "connections" and other content of the LinkedIn page, the court held that such information did not constitute a trade secret because it was publicly posted on the internet.

X. PUBLICLY AVAILABLE INFORMATION

a. In General

In *AvidAir Helicopter Supply, Inc. v. Rolls-Royce Corp.*, 663 F.3d 966 (8th Cir. 2011), the Court held as follows:

> Compilations are specifically contemplated in the UTSA definition of a trade secret, and the fact that some or even most of the information was publicly available is not dispositive of the first factor in the UTSA definition. Compilations of non-secret and secret information can be valuable so long as the combination affords a competitive advantage and is not readily ascertainable. . . . Compilations are valuable, not because of the quantum of secret information, but because the expenditure of time, effort, and expense involved in its compilation gives a business a competitive advantage. . . . This value is not dependent on how much of the information is otherwise unavailable because "the effort of compiling useful information is, of itself, entitled to protection even if the information is otherwise generally known."

b. Partial Versus Unlimited Disclosure

For an illustration of the threat which the internet poses to the ability of companies to protect their trade secrets, it is instructive to compare *DVD Copy Control Ass'n, Inc. v. Bunner*, 116 Cal. App. 4th 241 (Cal. App. 6th Dist. 2004) with *Data Gen'l Corp. v. Digital Computer*

Controls, Inc., 357 A.2d 105 (Del. Ch. 1975). Both cases deal with the potential disclosure of trade secrets information and its impact on the ability of the holder to protect its interests. In *Data General*, a case which occurred prior to the internet era, a manufacturer made certain secret information available through product manuals and other generally available technical documents. When plaintiff brought suit to protect its trade secrets, defendant argued that plaintiff had failed to take adequate steps to prevent its trade secrets from becoming public property. Noting that plaintiff took "customary precautions" against disclosure, including certain terms in its sales agreement regarding confidentiality, and the inclusion of a "proprietary legend" on the technical documents, as well as ensuring its employees maintain confidentiality, the court concluded that "plaintiff has trade secrets" in the information appropriated by defendants. Crucially, the court found that defendant's allegation that other competitors of plaintiff used the allegedly secret information was unsupported by the record.

In*DVD Copy Control*, however, the court was faced with a situation in which the information that plaintiff claimed trade secret protection of had been widely disseminated across the internet. In *DVD Copy Control*, Plaintiff alleged that secret information which allowed users to circumvent copy-protection software included on DVDs had been impermissibly "reverse engineered". After it was reverse engineered, this information was broadly distributed on the internet to a large number of users, including defendants. The court found that the "secrecy" element of a trade secret was implicated by the current facts in two principle ways: "First, if the allegedly proprietary information contained in DeCSS was already public knowledge when [defendant] posted the program to his Web site, [defendant] could not be liable for misappropriation by republishing it because he would not have been disclosing a trade secret. Second, even if the information was not generally known when [defendant] posted it, if it had become public knowledge by the time the trial court granted the preliminary injunction, the injunction (which only prohibits *disclosure*) would have been improper because [plaintiff] could not have demonstrated interim harm." Finding that there "is no evidence to support" a finding that the proprietary information was not widely known at the time it was posted by defendant, the court of Appeals reversed the lower court's grant of injunctive relief.

Synthesizing these approaches, the federal district court for the District of New Jersey, in *Syncsort Inc. v. Innovative Routines, Int'l, Inc.*, No. 04-3623, 2011 U.S. Dist. LEXIS 92321 (D.N.J. Aug. 18, 2011) addressed a situation defendant had improperly obtained proprietary information and, when faced with a lawsuit, attempted to find that information (a "Reference Guide") on the internet. Ultimately, defendant located several incomplete versions of the Reference Guide, and three complete versions. Addressing whether this public disclosure was sufficient to vitiate trade secret protection, the court applied both *Data General* and *DVD Copy Control*. Under *Data General*, the court found that the disclosure of the partial sources was insufficient to vitiate trade secrets protection. Under *DVD Copy Control*, the court found that the "complete" versions of the Reference Guides all came from web sites which were either password protected or had been promptly removed once notice was served on them. Finding these disclosures insufficient to eliminate the secrecy of the information, the court allowed plaintiff's suit to continue.

XI. INDEPENDENT DEVELOPMENT

In *Moore v. Kulicke & Soffa Indus., Inc.*, 318, F.3d 561 (3d Cir. 2003), the Third Circuit faced this question. The Court of Appeals affirmed a lower court judgment, holding that independent development by a defendant was not of itself an affirmative defense against a trade secret claim, but that it did shift the burden to the plaintiff to prove that there was no independent development. One judge concurred in the judgment only, holding that independent development and use of a trade secret were "mutually exclusive," but that the trade secret claim had already failed on other grounds.

XII. NEGATIVE TRADE SECRETS – KNOWING WHAT NOT TO DO CAN BE A TRADE SECRET

Acquiring knowledge, after the expenditure of significant time and money, that certain processes or techniques are ineffective can be a "negative" trade secret. In *Morton v. Rank Am., Inc.*, 812 F. Supp. 1062 (C.D. Cal. 1993), the court noted that it was a mistake to focus "only on information that might be generally observable by members of the general public" in determining the existence of a trade secret. Following this line of analysis, the court found that "[c]ertain 'negative' research may also result in the creation of protectable information" so long as that information "derives independent economic value…from not being generally known to the public." *Id.* at 1073-74 (internal citations and quotations omitted); *See also Courtesy Temporary Serv. V. Camacho*, 222 Cal. App.

XIII. INEVITABLE DISCLOSURE DOCTRINE

a. Summary of the Doctrine

Under the inevitable disclosure doctrine, employers are sometimes able to hold a former employee liable for misappropriation of trade secrets, without having to prove that the former employee has actually done so. Under the doctrine, a former employee may be held liable for trade secret misappropriation if it is found that, based on the nature of the former employee's new job, it is inevitable that the former employee will rely on his or her knowledge of the former employer's trade secrets in working for the new employer.

The doctrine applied by the Third Circuit, in *Bimbo Bakeries USA, Inc. v. Botticella*, 613 F.3d 102 (3d Cir. 2010). In *Bimbo Bakeries,* a former senior executive from Bimbo Bakeries USA, Inc. ("Bimbo"), Chris Botticella, was enjoined from working for one of Bimbo's competitors, because he was one of the few people in the world who knew the secret formula for creating the famous "nooks and crannies" in one of Bimbo's products – Thomas' English Muffins. In upholding the injunction which had been issued by the district court below, the Third Circuit held that the question was not whether Botticella would *inevitably* disclose the secret formula to his new employer, but rather '"whether there is sufficient likelihood, or substantial threat' of [Botticella] disclosing trade secrets" – a standard which the Court held was met in the case at hand.

In *American Airlines, Inc. v. Imhof,* 2009 U.S. Dist. LEXIS 46750 (S.D.N.Y. June 3,2009), the Court held that the application of the "inevitable disclosure doctrine" would bind the employee to an "implied in fact covenant not to compete, which runs counter to New York's public policy against such covenants and the strict scrutiny applied by the Courts in reviewing them." The Court further held that loose application of the "inevitable disclosure" doctrine would stifle competition and the free flow of talent.

Finally, the Court required for application of the doctrine that the employee have knowledge of actual confidential information and that there be deliberate misappropriation of the information.

b. States Which Apply the Inevitable Disclosure Doctrine

- **Arkansas**:

  - *Bendinger v. Marshalltown Trowell Co.*, 994 S.W.2d 468 (Ark. 1999) (noting that "this court adopted the inevitable-disclosure rule in Cardinal Freight Carriers v. J.B. Hunt Transportation Service. 336 Ark. 143, 152, 987 S.W.2d 642, 646. In that case, we recognized that a number of federal cases dealing with trade secrets have held that a plaintiff may prove a claim of trade-secrets misappropriation by demonstrating that a defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets.").

  - *Cardinal Freight Carriers, Inc. v. J.B. Hunt Transp. Servs., Inc.*, 987 S.W.2d 642 (Ark. 1999) (following the precedent set by "a number of federal cases dealing with trade secrets [which] hold that a plaintiff may prove a claim of trade-secret misappropriation by demonstrating that a defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets").

  - *Cellco Partnership v. Langston*, No. 4:09CV00928 JMM (W.D. Ark. Dec. 23, 2009), copy of order available at http://www.fox16.com/media/lib/9/6/f/4/6f410448-bee0-4ea0-ba43-440fa4eaedcd/Order_denying_TRO_Motion_122309.pdf. (denying plaintiff's motion for injunction, in part because the court did not believe that the defendant would inevitably disclose trade secrets that he acquired with his former employer).

    - M. McClure, *Arkansas Court Limits Use of Inevitable Disclosure Doctrine*, Arkansas Employment Law (Jan. 2, 2010), http://www.aremploymentlaw.com/post/Arkansas-Court-Limits-Use-of-Inevitable-Disclosure-Doctrine.aspx.

- *Texarkana Beh. Assoc., L.C. v. Universal Health Svcs., Inc.*, 2010 U.S. Dist. LEXIS 114112 (W.D. Ark. Oct. 26, 2010).

    - Kenneth J. Vanko, *Court Rejects "Inevitable Disclosure Claim Arising Out of Failed Transaction (Texarkana Beh. Assoc. v. Universal Health),* Legal Developments in Non-Competition Agreements (Nov. 4, 2010), http://www.non-competes.com/2010/11/court-rejects-inevitable-disclosure.html.

- *City Slickers, Inc. v. Douglas*, 40 S.W.3d 805 (Ark. Ct. App. 2001) (The dissent, faulting the majority for failing to address the inevitable disclosure theory, stated: "The majority failed to address this issue, but the inevitable disclosure inquiry is a factual inquiry that may include consideration of the similarity of the employee's new job to the position he held with his former employer and consideration of whether or not he exhibited a lack of compunction about using his former employer's proprietary information to gain an unfair tactical advantage. The inevitable disclosure principle seems squarely applicable here, as it is difficult to conceive of how appellee, with no prior experience in the automotive oil changing industry, could *operate an on-site oil changing facility after a mere six weeks of training without misappropriating the information provided by City Slickers.*")

- **Delaware**:

    - *E.I. DuPont de Nemours & Co. v. American Potash & Chem. Corp.*, 200 A.2d 428 (Del. Ch. 1964) (the case which first acknowledged the applicability of the inevitable disclosure doctrine in Delaware).

    - *W.L. Gore & Assoc, Inc. v. Wu*, 2006 Del. Ch. LEXIS 176 (Del. Ch. 2006) (holding that Delaware courts have the power to "limit a defendant from working in a particular field if his doing so poses a substantial risk of the inevitable disclosure of trade secrets.").

    - Barry M. Willoughby, *The Inevitable Disclosure Doctrine in Delaware*, Delaware Non-Compete Law Blog (July 15, 2010), http://www.delawarenoncompetelawblog.com/2010/07/the-inevitable-disclosure-doct.html?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+DelawareNon-competeLawBlogCom+%28Delaware+Non-Compete+Law+Blog%29.

- **Illinois**:

    - *C & F Packing Co. v. IBP, Inc.*, 1998 U.S. Dist. LEXIS 3221, No. 93-c-1601 (N.D. Ill. March 17, 1998) (holding that "a party may be held liable for the misappropriation of a trade secret as a consequence of hiring a competitor's employee and placing that employee in a position that would result in the inevitable disclosure or use of the trade secret… Such a finding is appropriate when a defendant hires the employee of a competitor who knows his past employer's trade secrets and then places the employee in a job with similar or identical duties to those performed while working for the competitor. A finding of liability reached in this manner is premised on the realization that unless an employee possesses 'an uncanny ability to compartmentalize information, he will necessarily' be relying on and using his former employee's trade secrets.") (internal citations omitted).

- **New York**:

  - *American Airlines, Inc. v. Imhof*, 2009 U.S. Dist. LEXIS 46750 (S.D.N.Y. June 3, 2009) (denying an injunction against a salesman under the doctrine).

    - Kenneth J. Vanko, *Proving Inevitable Disclosure No Easy Task Against Salesmen (American Airlines v. Imhof)*, Legal Developments in Non-Competition Agreements (June 8, 2009), http://www.non-competes.com/2009/06/proving-inevitable-disclosure-no-easy.html

  - *Doubleclick, Inc. v. Henderson*, 1997 N.Y Misc. LEXIS 577, No. 116914/97 (Super. Ct. N.Y. Nov. 5, 1997) (holding that "Injunctive relief may issue where a former employee's new job function will inevitably lead her to rely on trade secrets belonging to a former employer.").

  - *IBM v. Papermaster*, 2008 U.S. Dist. LEXIS 95516 at *22-*23 (S.D.N.Y. 2008) (holding that "[w]here a court finds that an employee is in possession of trade secret information, the court must still determine whether that employee has actually misappropriated the information or whether the new employment 'creates a risk that disclosure of this information is inevitable.'") (quoting *Payment Alliance Int'l, Inc. v. Ferreira*, 530 F. Supp. 2d 477, 482 (S.D.N.Y. 2007)).

- **North Carolina:**
  - *Merck & Co. Inc. v. Lyon*, 941 F. Supp. 1443 (M.D.N.C. 1996). The court stated as follows:
    - "In finding a likelihood of disclosure, other courts that have applied the inevitable disclosure theory have considered the degree of competition between the former and new employer, and the new employer's efforts to safeguard the former employer's trade secrets, and the former employee's 'lack of forthrightness both in his activities before accepting his job . . . and in his testimony,' as well as the degree of similarity between the employee's former and current position. Pepsico, supra, 54 F.3d at 1267; Pepsico, 1995 U.S. Dist. LEXIS 19380, NO. 94 C 6838, 1996 WL 3965, at *20 (N.D.Ill. Jan. 2, 1996)(citing IBM Corp. v. Seagate Technology, Inc. 1991 U.S. Dist. LEXIS 20406, at *7 (D. Minn. 1991)). These, too, are factors which are consistent with the approach adopted by the North Carolina courts."

c. States Which Have Rejected the Inevitable Disclosure Doctrine

- **California**:

    - *Whyte v. Schlage Lock Co.*, 101 Cal. App. 4th 1443, 1463 (Cal. Ct. App. 2002) . The court, collecting cases pro and con, emphatically stated that its "rejection of the inevitable disclosure doctrine is complete." The court found that
        - "[t]he chief ill in the covenant not to compete imposed by the inevitable disclosure doctrine is its after-the-fact nature: The covenant is imposed *after* the employment contract is made and therefore alters the employment relationship without the employee's consent. When, as here, a confidentiality agreement is in place, the inevitable disclosure doctrine 'in effect convert[s] the confidentiality agreement into such a covenant [not to compete]." (*PCS, Inc. v. Reiss*, *supra*, 111 F.Supp.2d at p. 257.) Or, as another federal court put it, '[a] court should not allow a plaintiff to use inevitable disclosure as an after-the-fact noncompete agreement to enjoin an employee from working for the employer of his or her choice.' *Del Monte Fresh Produce Co. v. Dole Food Co., Inc.*, *supra* 148 F.Supp.2d at p 1337; *see also* Matheson, *Employee Beware: The Irreparable Damage of the Inevitable Disclosure Doctrine*, 10 Loyola Consumer L. Rev. 145, 162 (1998).

    - *Aware, Inc., v. Ramirez-Mireles*, 2001 Mass. Super. LEXIS 221 (Mass. 2001). (Applying California law, holding that "What is clear, however, is that in a conflict between the policy favoring employee mobility free of encumbering restriction and the policy favoring protection of trade secrets, employee mobility prevails in California. The theory of 'inevitable disclosure' of trade secrets is not the law of California. See Bayer Corp. v. Roche Molecular System, Inc., 72 F. Supp. 2d 1111, 1112 (N.D. Cal. 1999).").

    - *Electro Optical Industries, Inc. v. White*, 76 Cal. App. 4th 653 (Cal. Ct. App. 1999) (prior to *White* and *Aware, Inc.*'s rejection of the rule, the court adopted the inevitable disclosure rule).

- **Maryland**:

    - *LeJeune v. Coin Acceptors, Inc.*, 849 A.2d 451 (Md. 2004) (citing with approval the decision of the California Court of Appeals in *Whyte*, 101 Cal. App. 4th 1443, the court found that Maryland has a policy in favor of employee mobility similar to that of California and that, given that defendant did not enter into a confidentiality or covenant not to compete with LeJeune, to recognize "inevitable disclosure" in this case would let defendant influence plaintiff's employment relationship even despite its failure to negotiate the appropriate agreements.).

- *CMI Int'l v. Intermet Int'l Corp.*, 649 N.W.2d 808 (Mich. App. 2002) (failing to apply the doctrine of inevitable disclosure, and stating that the doctrine "must not compromise the right of employees to change jobs." (citing Hayes-Albion Corp v Kuberski, 364 N.W.2d 609 (Mich. 1984).

- **<u>Virginia</u>**:

    - *Gov't Tech. Servs., Inc. v. IntelliSys Tech. Corp.*, 51 Va. Cir. 55 (Fairfax Cty. Cir. Ct. 1999) (holding that, under the Virginia Trade Secrets Act, "only actual or threatened misappropriation may be enjoined," as "Virginia does not recognize the inevitable disclosure doctrine").

    - Dan Firth, *Inevitable Disclosure: What is it?*, Virginia Non-Compete Law Blog (Dec. 4, 2009), http://virginianoncompete.blogspot.com/2009/12/inevitable-disclosure-what-is-it.html, ("I am happy to report, and fortunately for employees, the state of Virginia does not recognize the doctrine of inevitable disclosure… at least according to the Circuit Court of Fairfax County.") (citing *Gov't Tech. Servs., Inc.*).

<u>d. Inevitable Disclosure vs. Threatened Misappropriation</u>

Note, however, that some states, including some states which have rejected the inevitable disclosure doctrine, may nevertheless make a distinction between application of the inevitable disclosure doctrine, and enjoining threatened misappropriation of trade secrets, and may continue to enjoin threatened misappropriation. *See, e.g.*:

- *Central Valley Gen. Hosp. v. Smith*, 162 Cal. App. 4th 501, 525 (Cal. Ct. App. 2008) (holding that "the principle that threatened misappropriation of trade secrets may be enjoined is the law of California despite the rejection of the inevitable disclosure doctrine by California courts").

- *CMI Int'l, Inc. v. Intermet Int'l Corp.*, 649 N.W.2d 808 (Mich. Ct. App. 2002). (Auto parts manufacturer sued competitor and former chief technical officer for, *inter alia*, threatened misappropriation of trade secrets, relying on the inevitable disclosure concept. The court held that, assuming the concept was encompassed within the notion of "threatened misappropriation," the party must establish more than the existence of generalized trade secrets and a competitor's employment of the party's former employee who has knowledge of the trade secrets. Otherwise, the concept would compromise the right of employees to change jobs.)

- Dale C. Campbell, *Threatened Misappropriation of Trade Secrets vs. Inevitable Disclosure Doctrine – When Is the Line Crossed?*, The IP Law Blog (Apr. 13, 2009), http://www.theiplawblog.com/archives/-trade-secrets-threatened-misappropriation-of-trade-secrets-vs-inevitable-disclosure-doctrinewhen-is-the-line-crossed.html.

XIV. WHAT CONSTITUTES "USE" OF A TRADE SECRET?

In *PMC, Inc. v. Kadisha*, 78 Cal. App. 4th 1368 (2000), the court was faced with the question of whether certain conduct constituted "use" of a trade secret within the meaning of California's Uniform Trade Secrets Act, Cal. Civ. Code § 3426 *et seq.* Interpreting the "plain terms" of the Act, the court held that "[e]mploying the confidential information in manufacturing, production, research or development, marketing goods that embody the trade secret, or soliciting customers through the use of trade secret information, all constitute use." *PMC*, 78 Cal. App. 4th at 1382-83 (*quoting* Restatement (Third) Unfair Competition, § 40, comment c). That said, the court went on to hold that "[u]se of a trade secret without knowledge it was acquired by improper means does not subject a person to liability unless the person receives notice that its use of the information is wrongful."

XV. FRANCHISE ISSUES

In October of 2010, the "Trading Secrets" blog conducted an interview with Mr. W.C. Garth Snider, the President and General Counsel of the Franchise Opportunities Network. In that interview, Mr. Snider opined on several issues that he saw as being of importance in the franchise context. Initially, Mr. Snider pointed out that a franchise's "success is derivative of the ability of the franchisor, 1) to protect the method and manner by which it distributes its product, and 2) the uniqueness of the product itself." Mr. Snider then noted that the "formula" used by franchises to establish or maintain these attributes, to the extent that it is not readily accessible to competitors, is a source of significant value. As an aside, Mr. Snider noted that the variety of information a franchise might seek to protect varies widely from secret recipes for products, to business methods, to supplier, customer, and pricing data.

To protect this information, Mr. Snider recommends that "nothing be left to chance" in the franchise agreement, which should be clear that trade secrets are being *licensed*, not sold. Mr. Snider further recommended a ban on "reverse-engineering" the trade secret, and disseminating frequent reminders of franchisee's obligations under the Agreement. The importance of clarity in drafting license provisions is illustrated by *Topps Co. v. Cadbury Stani S.A.I.C.*, 526 F.3d 63 (2d Cir. 2008), which found ambiguous a license agreement allowing defendant to use plaintiff's proprietary formulae. The agreement provided that "[plaintiff's formulae] shall at all times remain the exclusive property of [plaintiff] or its assigns" and that defendants were permitted to use the formulae only "during the continuance" of the license agreement. Nevertheless, the Second Circuit found the agreement ambiguous, because the "during the continuance" language may have been intended only to refer to the eventuality of an early termination, and there was no express provision dealing with rights to the formulae after the normal expiration of the agreement.

Finally, Mr. Snider noted that trade secrets can be difficult to value. Mr. Snider noted that there was no one method which could be applied in all cases but that, in general, the ease with which a trade secret might be duplicated was inversely proportional to its worth. To this must be added the value of the brand associated with the secret. Mr. Snider singled out customer lists as being difficult, but not impossible to value – the crucial factor at play in such a case is the care with which the list is protected and how widely it is distributed.

XVI. Calculation of Damages for Disclosure or Use of Trade Secrets

a. Calculating Damages Generally

In *Bohnsack v. Varco, L.P.*, 2012 U.S. App. LEXIS 1251 (5th Cir. Jan. 23, 2012), the Fifth Circuit examined the proper measure of damages for the misappropriation of trade secrets. First, the Court surveyed the various approaches used to address this question, including:

> The value of plaintiff's lost profits (*Jackson v. Fontaine's Clinics, Inc.*, 499 S.W.2d 87 (Tex. 1973));
> The defendant's actual profits from the use of the secret (*Elcor Chem. Corp. v. Agri-Sul, Inc.*, 494 S.W.2d 204 (Tex. Civ. App. 1973));
> The value that a reasonably prudent investor would have paid for the trade secret (*Precision Plating & Metal Finishing Inc. v. Martin-Marietta Corp.*, 435 F.2d 1262 (5th Cir. 2006));
> The development costs the defendant avoided incurring through misappropriation (*Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1974)); and
> A "reasonable royalty" (*Elcor Chem. Corp.*, 494 S.W.2d at 214).

Based on the numerous approaches, the Court concluded that courts had adopted a "flexible" approach to the calculation of damages for claims of misappropriation of trade secrets. Accordingly, the Court affirmed an award for $600,000, noting that, while plaintiff had not proven his "precise damages" that such uncertainty should not preclude recovery if the jury had "sufficient evidence to infer that a reasonably prudent investor would have been willing to pay at least $600,000 for the rights to use the [trade secret]."

b. The "Reasonable Royalty" Method of Damage Calculation

While courts often refer to some combination of "lost profits" or "unjust enrichment" theories, when neither of those theories are available, courts often apply a modified form of the "reasonable royalty" measure of damages used in patent infringement cases.

In *Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers Inc.*, 446 F.2d 295 (2d Cir. 1971), the Second Circuit outlined the basic analysis for calculating a "reasonable royalty" in a patent case. First, the Court noted that the trial court correctly chose to apply the "willing buyer-willing seller" rule. This rule "contemplates a suppositious meeting in advance of infringement between patent owner and potential infringer in order to work out a license agreement." *Id.* at 296-97. Numerous factors may be relevant to such an analysis, including the competitive environment, the life of the patent, the popularity of the product, the expected profits on both sides, the relative importance of the patent, and comparable royalties on similar patents. Obviously, this calculation is a highly fact-specific exercise.

There are two methods of calculating reasonable royalties, the analytical method and the hypothetical negotiation or "willing licensor-willing licensee" approach. *See Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009). The analytical method focuses on the infringer's projections of profit for the infringing product. The second method, described in *Georgia-Pacific*, above, attempts to ascertain the royalty that parties would have agreed upon themselves. The guiding principle in that analysis is to attempt to re-crate, as best possible, the *ex ante* licensing negotiation scenario and to describe the resulting agreement. *Lucent*, 580 F.3d at 1325.

In *Ajaxo Inc. v. E*Trade Fin. Corp.*, 187 Cal. App. 4th 1295 (Cal. Ct. App. 6th Dist. Aug. 30, 2010), the California Court of Appeals held that, under California law, it was appropriate to award fees based on the calculation of a reasonable royalty when defendant has not been unjustly enriched by the misappropriation of the trade secret. *See also Vermont Microsystems v. Autodesk, Inc.*, 138 F.3d 449, 451 (2d Cir. 1998); *Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1978) (both applying reasonable royalty measure of damages in trade secrets cases). While the Uniform Trade Secrets Act and Federal patent law both require actual damages and unjust enrichment to both be "unprovable" before a reasonable royalty may be awarded, California law contains no such requirement. *Ajaxo*, 187 Call. App. 4th at 1308-09.

In *Columbus Steel Castings Co. v. King Tool Co.*, Nos. 11AP-351, 11AP-355, 2011 Ohio App. LEXIS 5648 (Ohio Ct. App. Dec. 30, 2011), the court set a "reasonable royalty" after a jury found that defendant had misappropriated plaintiff's trade secret but awarded no damages. While the decision of the Court of Appeals affirming the trial court's award does not enumerate the precise method by which the reasonable royalty was calculated, it appears that the court used the analytical method described above. In so doing the court relied on expert testimony regarding the overall importance of the trade secret, and the amount by which the trade secret increased production.

XVII. JURY TRIAL

a. Right to a Jury Trial on Damages

In *Evans v. Gen. Motors Corp.*, 893 A.2d 371 (Conn. 2006), the plaintiff, an inventor, sued General Motors, alleging that it has misappropriated trade secrets in violation of the Connecticut Uniform Trade Secrets Act. Plaintiff sought jury trial on his claims. Following an extensive historical analysis, the Connecticut Supreme Court included that the plaintiff was entitled to jury trial on his trade secrets claims seeking damages. The Connecticut Supreme Court recognized that previously no court had expressly held that a plaintiff had a right to a jury trial on the damages aspects of a trade secrets claim.

In *Specialized Tech. Res., Inc. v. JPS Elastomerics Corp.*, 957 N.E.2d 1116 (Mass. Ct. App. Nov. 23, 2011), the lower court had submitted to the jury, via special interrogatory, plaintiff's claim for misappropriation of trade secrets. The jury found that no misappropriation had occurred. The trial judge disagreed with the jury, and granted over $1 million in damages, $3.9 million in attorney's fees, and costs in excess of $1 million. The court also awarded injunctive relief requiring defendant to disassemble the manufacturing line constructed with plaintiff's trade secrets and to refrain from making a competing product, by any means, for a period of five years.

Defendant appealed, arguing, in part, that the trial judge was without authority to make findings contrary to those of the jury. The Court of Appeals affirmed, holding that there is a "rich body of precedent supporting a trial judge's authority to enter findings inconsistent with those of the jury" in claims for misappropriation of trade secrets arising under Mass. G. L. c. 93A. *See also Velleca v. Uniroyal Tire Co.*, 630 N.E.2d 297 (Mass. 1994). The trial court had specifically reserved the determination of the misappropriation claim for the court, and was not bound by the contrary findings made by the jury. Accordingly, the Court of Appeals affirmed the trial court's ruling.

Similarly, in *Columbus Steel Castings Co. v. King Tool Co.*, Nos. 11AP-351, 11AP-355, 2011 Ohio App. LEXIS 5648 (Ohio Ct. App. Dec. 30, 2011), the trial court awarded a "reasonable royalty" to plaintiff when the jury found that defendant had misappropriated plaintiff's trade secret but found that plaintiff had suffered no damages.

b. Jury Instructions

In *Whitesell Int'l Corp. v. Whitaker*, No. 287569, 2011 Mich. App. LEXIS 99 (Mich. App. Jan. 18, 2011), defendant employee was sued by plaintiff-former employer for misappropriation of a manufacturing process which plaintiff contended was a trade secret. Defendant counterclaimed for tortious interference with a business relationship and expectancy, denying that the process constituted a trade secret on the grounds that it was not confidential. Defendant contended that the process was readily visible to plant visitors, and was detailed in an expired patent. Defendant also noted that plaintiff did not require its employees to sign confidentiality agreements regarding the process. Following trial, but prior to submitting the question to the jury, defendant moved for a directed verdict on the issue of whether plaintiff's manufacturing process was a trade secret. The court granted this motion, and communicated to the jury that plaintiff's process was not a trade secret. Among the questions submitted to the jury for determination was whether plaintiff reasonably believed that the manufacturing process was a trade secret. Finding that it did not, the jury returned an award for defendant. On appeal, the Michigan Court of Appeals found that "[t]he judicial determination that there existed no trade secret undermined [plaintiff's] ability to argue that it reasonably believed that the [manufacturing process] was a trade secret." The court concluded that, given this ruling, the jury's decision "became a foregone conclusion". Finding that the trial court had committed error in granting the motion for a directed verdict, the Michigan Court of Appeals reversed the decision of the trial court to that extent, and remanded the case for further proceedings.

In *Columbus Steel Castings Co. v. King Tool Co.*, Nos. 11AP-351, 11AP-355, 2011 Ohio App. LEXIS 5648 (Ohio Ct. App. Dec. 30, 2011), plaintiff appealed a jury verdict finding that defendant had misappropriated its trade secret, but finding no damages. On appeal, plaintiff challenged the following jury instruction:

> "If you conclude that [plaintiff] has proven actual, compensatory damages were suffered that were proximately caused by Alliance misappropriating its trade secret, then you should enter that number in the appropriate blank on the Verdict form for plaintiff. If you find that no damages were proven by the greater weight of the evidence, then you shall enter 'zero' on the plaintiff's Verdict form."

Plaintiff argued that the second sentence of the instruction required them to "prove a negative, improperly emphasized a specific amount – zero, and implied that the jury should consider only direct evidence. The Court of Appeals found that the instruction was proper, and in accordance with prior authority, and sustained the decision on this point.

XVIII. ARBITRATION OF TRADE SECRETS DISPUTES

In *Noodles Dev. LP v. Latham Noodles, LLC*, No. CV 09-1094, 2009 U.S. Dist. LEXIS 81773 (D. Ariz. Aug. 26, 2009), the court was needed to determine whether a complaint alleging trademark and trade dress infringement, misappropriation of trade secrets, and breach of contract were required to be submitted to arbitration pursuant to an arbitration clause contained in a franchise agreement (the "Agreement") between the parties. The Agreement required arbitration of "any dispute or claim relating to or arising out of this Agreement". Noting that the Ninth Circuit has held that the phrase "arising out of or relating to" creates "an arbitration clause that is 'broad and far reaching' in scope, the court held that the claims must be submitted to arbitration. *Citing Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1131 (9th Cir. 2000). The court explained that these claims have a "significant relationship" to the agreement, and must therefore be submitted to arbitration, because their "factual predicate" was the misuse of plaintiff's marks and system. As this formed the "core subject" of the Agreement, the claims for trademark and trade dress infringement, misappropriation of trade secrets, and breach of contract were required to be arbitrated. *See also Filimex, L.L.C. v. Novoa Invs., L.L.C.*, No. CV 05-3792, 2006 U.S. Dist. LEXIS 56039 (D. Ariz. July 17, 2006) (similar claims arbitrable under a clause covering "any dispute…arising under or pursuant to" a licensing agreement).

XIX. FEE SHIFTING UNDER THE TRADE SECRETS ACT

a. An Approach from the Lanham Act

The Trade Secrets Act allows a plaintiff to recover fees if the defendant's misappropriation is "willful", and for the defendant to recover fees if the suit was maintained in "bad faith". Despite the significance of fee shifting to litigation under the Trade Secrets Act, guidance on this issue is sparse. In *Nightingale Home Healthcare, Inc. v. Anodyne Therapy, LLC*, 62 F.3d 958 (7th Cir., 2010), Judge Posner, writing for a panel of the Seventh Circuit, adopted a novel approach toward fee shifting under the Lanham Act which may also have application in the realm of trade secrets litigation.

In *Nightingale*, Judge Posner noted that disputes between competitors are often primarily about litigation costs themselves, explaining that these suits can be brought by established entities to drive out new entrants, or that infringers may adopt scorched-earth defense strategies to defeat otherwise meritorious claims by relatively shallow-pocketed claimants. Fee shifting under the Lanham Act is permitted only in "exceptional circumstances", but Judge Posner determined that it was appropriate to determine the public policy behind fee shifting in determining whether exceptional circumstances existed. Reasoning from there, Judge Posner opined that, rather than engaging in an "elaborate inquiry into the state of mind of the party from whom reimbursement of attorneys' fees is sought", that it was more appropriate to look at objective indicia that demonstrate an intent to browbeat the other side into submission with legal costs. In so doing, Judge Posner drew analogies to the tort of abuse of process.

a. Indemnification

In *Nicholas Labs., LLC v. Christopher Chen*, 199 Cal. App. 4th 1240 (Cal. Ct. App. 2011), the court found that Cal. Lab. Code § 2802 did not require the employer to reimburse its employee for attorney fees incurred in the employee's successful defense of the employer's action against the employee. Plaintiff-employer filed suit against its employee on several theories related to the alleged theft of company property, misuse of a corporate credit card, and alleged diversion of business opportunities. The trial court entered a verdict in favor of defendant, at which point defendant requested indemnification under Cal. Lab. Code § 2802, Cal. Corp. Code § 317, and various contractual provisions. The California Court of Appeals rejected each defendant's rationales for indemnification, holding that Cal. Lab. Code § 2802 was applicable "to third party claims against an employee, but not to claims by an employer against its own employees." As to Cal. Corp. Code § 317, the court found that defendant had not established that he was an agent/employee within the meaning of the statute.

Similarly, in *Am. Family Mut. Ins. Co. v. Roth*, 886 N.E.2d 1149 (Ill. Ct. App. 2008), the court found that the employer was not required to defend the insured defendants in an underlying trade secret misappropriation action the company had brought against them in federal court. While this case was decided primarily on the language of the contract, it is another indication that courts will be reluctant to enforce indemnification/defense provisions when the party bringing the suit is the employer providing the guaranty in the first instance.

XX. Injunctions in Trade Secrets Cases

a. Damages Award Does Not Preclude Injunction

In *Litigation Mgmt, Inc. v. Bourgeois,* 2011 Ohio 2794 (Ct. App. June 9, 2011), the Ohio Court of Appeals addressed whether an award of damages for past trade secret misappropriation precluded injunctive relief under the theory that such an award established that there was an adequate remedy at law. In holding that an award of damages did not preclude injunctive relief, the court noted that "[a]lthough it is said that injunctions will not be granted unless there is a showing of both irreparable harm and an inadequate remedy at law, in the context of permanent injunctions, those two requirements are essentially one and the same." Finding that the [existence of an actual threat of irreparable injury may be established by showing that the employee possessed knowledge of the employer's trade secrets", and explaining that "the point of a 'secret' is that no one else knows about it", the court turned to the trial court's contention that injunctive relief was unavailable because adequate legal relief had been awarded. *Id.* at 15-16 (quoting *Levine v. Beckman*, 548 N.E.2d 267 (Ohio Ct. App. 1988)). The court explained that injunctive relief was available because, unlike damages which operated retrospectively, the purpose of an injunction was to prevent *future* harm. Finding that, absent injunctive relief, the misuse of plaintiff's trade secrets would continue, the court held that this constituted irreparable harm for which there was no adequate remedy at law, and provided injunctive relief.

b. Duration of Injunctions

In *Verigy US, Inc. v. Mayder*, No. C-07-04330, 2008 U.S. Dist. LEXIS 28315 (N.D. Cal. Feb. 28, 2008) the court entered a preliminary injunction against four defendants related to their use of confidential information and trade secrets. Defendants-former employees of plaintiff, had used trade secrets in developing a competitive product, though the final version of that product did not make use of the trade secrets. In entering the injunction restricting the marketing and sale of the competitive product, the court was faced with the difficult question of the proper length of the injunction. The court answered this question by attempting to determine how much of a "head start" the use of plaintiff's trade secrets had given defendants. Noting that the plaintiffs had worked on projects related to the development of the trade secrets at issue for approximately eight months, the court nevertheless shortened the duration of the restriction to five months. The court did so because some of the technology used in the final product was publicly available and because the final product did not make use of the trade secrets at issue.

XXI. TRADE SECRETS AND CRIMINAL LAW

a. The Economic Espionage Act

The Economic Espionage Act, 18 U.S.C. § § 1831-39, was enacted by Congress in 1996 for the purpose of "adopt[ing] a national scheme to protect U.S. proprietary economic information." The EEA criminalizes knowing conversion of a trade secret placed in interstate commerce.

In order to be convicted under the EEA, the government must show:

1) That defendant intended to convert the trade secret, with knowledge that the information was proprietary, for the benefit of an individual or entity who did not own it and knew that the owner would be injured thereby;
2) That the trade secret is in interstate commerce
3) That defendant misappropriated, stole, or destroyed the trade secret;

The EEA also criminalizes attempts and conspiracies to perform acts prohibited by the EEA.

The EEA imposes stiff penalties on conduct which violates its terms. A foreign individual carries a maximum sentence of up to 15 years in prison and a fine of up to $500,000. A foreign corporation or other foreign organization which violates the EEA may be subject to a maximum fine of $10 million. Domestic individuals face up to ten years in prison – penalties for violations by domestic individuals or corporations are otherwise half of what they are for foreign individuals or corporations.

b. Theft of Trade Secrets

Even absent the EEA, individuals may face criminal liability for the theft of trade secrets. In *DuCom v. State*, 654 S.E.2d 670 (Ga. Ct. App. 2007) (*cert. denied* 2008 Ga. LEXIS 383 (Ga. Apr. 21, 2008)), the George Court of Appeals upheld the conviction of defendant-appellant Ms. Shan DuCom for theft of a trade secret, under OCGA § 16-8-13; theft by taking, under OCGA § 16-8-2; and computer theft, under OCGA § 16-9-93(a) for the theft of her prior employer's trade secrets. While the bad acts committed by Ms. DuCom are extensive, in brief, prior to leaving her employer to start a competing business, Ms. DuCom absconded with a large quantity of both physical and electronic files, removed the same from her employer's files and computer, deleted and transferred large databases to her own computer(s), sabotaged the credit card and phone lines, and copied a "massive" amount of information – proprietary and otherwise – from her employer's computers onto portable media.

While criminal prosecution for the theft of trade secrets are rare, it is very much an issue that all practitioners should be cognizant of.

XXII. USE OF ANTI-SLAPP LAWS IN TRADE SECRET LITIGATION:

In *World Fin. Group, Inc. v. HBW Ins. & Fin. Serv., Inc.*, 172 Cal. App. 4th 1561 (Cal. App. 2d Dist. 2009), plaintiff World Financial Group ("WFG") sued its competitor HBW Insurance

("HBW"), as well as a number of former WFG associates, in part alleging trade secret misappropriation and use of WFG's confidential information to solicit WFG's associates and customers.

The Defendants filed a motion for WFG's complaint to be dismissed on the basis of California's anti-SLAPP law, arguing that WFG's claims were based on the defendants' speech and conduct in furtherance of their free speech rights in connection with a public issue. The purported public interests and policies which the defendants claimed were implicated by their speech and conduct included the pursuit of lawful employment, workforce mobility, and free competition.

Both the trial Court, and the California Court of Appeals, rejected the defendants' argument for the application of the anti-SLAPP law, holding that the defendants failed to show that WFG's complaint arose from speech and conduct in connection with a public issue. The Court of Appeals reasoned that the conduct and speech at issue was committed in a business capacity, "for the sole purpose of promoting the competing business as a superior employer and provider of products and services", and therefore was not speech in connection with a public issue. Further, the Court held that the statements by which the defendants sought to solicit WFG's employees and customers were merely incidental to the conduct upon which WFG's complaint was based. Finally, the Court also rejected the defendants' attempts to couch their arguments for the application of the anti-SLAPP statute on society's general interest in the subject matter of the dispute (free competition and the like). The Court held that "[t]he focus of the anti-SLAPP statute must be on the specific nature of the speech rather than on generalities that might be abstracted from it," because otherwise, "every case alleging breach of a noncompetition agreement or the related misappropriation of trade secrets would be categorically subject to the anti-SLAPP statute."

XXIII. Communicating Confidential Trade Secrets to One's Attorney

In *JDS Uniphase Corp. v. Jennings*, 473 F. Supp. 2d 697, 704 (E.D. Va. 2007), the court found that "[o]rally transmitting arguably confidential information to a lawyer with an eye to suing the company is quite different from physically carting away stacks of documents, disks, or computers belonging to the business without authorization to do so and in contravention of a confidentiality agreement . . . [An employee] should not engage in self-help by wrongfully retaining an employer's documents; but instead the employee should file suit and seek the documents in question through appropriate discovery channels."

Further, the court noted that the anti-retaliation provisions under Sarbanes-Oxley cannot be read "to authorize disgruntled employees to pilfer a wheel barrow full of an employer's proprietary documents in violation of their [duty of loyalty or confidentiality agreements] merely because it might help them blow the whistle on an employer's violations of law, real or imagined. Endorsing such theft or conversion would effectively invalidate [the duty of loyalty and] most confidentiality agreements, as employees would feel free to haul away proprietary documents, computers, or hard drives, in contravention of their confidentiality agreements [or duty], knowing they could later argue they needed the documents to pursue suits against employers under a variety of statutes protecting employees from retaliation [for opposing discriminatory practices or participating in such actions].").

XXIV. THE FIFTH AMENDMENT

In *PCS4LESS, LLC v. Stockton*, Nos. 296870, 806 N.W.2d 353 (Mich. App. 2011), plaintiff sued both corporate and individual defendants, alleging misappropriation of trade secrets. Defendant initially denied that they possessed the products indicated by plaintiff, but refused to provide affidavits to that effect, insisting that such information was protected by the Fifth Amendment. The trial court nevertheless required both corporate and individual defendants to provide the requested affidavits.

The Michigan Court of Appeals overturned the trial court's decision, as it applied to the individual defendants, holding that their personal privilege against self-incrimination could be compromised if they, individually, were forced to comply. In so holding, the court noted that the Fifth Amendment privilege applied in situations, such as that here, where the act of producing the sought documents "may have testimonial aspects and an incriminating effect[.]"

However, noting that "organizations generally are not protected by the [fifth amendment]", (*United States v. White*, 322 U.S. 694 (1944)) the court held that, while a "corporation's action cannot prevail over an individual's Fifth Amendment rights" that "the corporation cannot take advantage of [an individual's invocation of her Fifth Amendment rights] to avoid answering interrogatories addressed to the corporation." While recognizing that a narrow exception may exist when "the only persons who could testify on behalf of the companies or produce requested documents are the same individuals whose personal Fifth Amendment rights are at stake", (*see United States v. Doe*, 465 U.S. 605 (1984)) the court found that this exception was inapplicable to the case before it and affirmed the decision of the lower court ordering the corporation to produce the affidavit.

XXV. PUBLICATION OF TRADE SECRETS AND FREEDOM OF THE PRESS

In *O'Grady v. Santa Clara County Superior Court*, 2006 Cal. App. LEXIS 802 (Cal. Ct App. May 26, 2006), the California Court of Appeals for the Sixth District held that the unauthorized publication on various Apple rumor blogs about a product Apple had in the works, while problematic under trade secrets law, must nonetheless be permitted in the interests of preserving a free press.

XXVI. USE OF TRADE SECRETS ON BEHALF OF THIRD PARTIES

Maryland law prohibits the use of another's trade secrets for the benefit of a third party. This fact pattern was presented to the court in *Tabs Assocs., Inc. v. Brohawn*, 475 A.2d 1203 (Md. Ct. Spec. App. 1984) in which defendants-former employees left plaintiff-employer to form an identical business servicing the same customers. In entering an injunction prohibiting the continuation of this business, the court held that "Maryland courts have enjoined the use of another's trade secrets for the benefit of a third-party business which profits from the acquisition of the trade secrets of another." The court further noted that it "is well established in Maryland that restrictive covenants may be utilized to prevent the 'future misuse of trade secrets' by employees.'" *See also E.L. Conwell & Co. v. Gutberlet*, 298 F. Supp. 623, *aff'd*, 429 F.2d 527 (4th Cir. 1970). The crucial question before the court is whether plaintiff possessed a protectable trade secret in its mail presorting methods. The defendants argued that a "simple common sense business procedure[]" cannot support a *prima facie* case. Relying heavily on the procedures used to keep the sorting techniques secret, the court concluded that plaintiff could make out a *prima facie* case despite this deficiency.

XXVII. EMPLOYER'S VICARIOUS LIABILITY FOR EMPLOYEE TRADE SECRETS VIOLATIONS

In *Newport News Indus. v. Dynamic Testing, Inc.*, 130 F. Supp. 2d 745 (E.D. Va. 2001) the court found that the new employer of plaintiff's ex-employee could be vicariously liable under Virginia Uniform Trade Secrets Act ("VUTSA") for misappropriation of trade secrets by its employee, acting within the scope of his employment. Even though the Act is silent whether respondeat superior applies, the court found the VUTSA does not preempt, or specifically or impliedly reject the doctrine. Thus, the court found "it is perfectly consistent to hold the employer liable for infringing acts of its employees committed within the scope of employee's scope of employment."

XXVIII. PREEMPTION OF COMMON LAW CLAIMS

In *Cenveo Corp. v. Slater*, 2007 U.S. Dist. LEXIS 9966 (E.D. Pa., Feb.13, 2007), a case involving the Pennsylvania Trade Secrets Act, 12 Pa. C.S. § § 5301-08, Judge Golden reviewed the authorities and the arguments, and concluded that it would be inappropriate to grant a motion to dismiss on the issue of preemption, and that he would reconsider the issue on a fully developed summary judgment record. Judge Golden declined to join those courts that have held that the state legislatures, in enacting trade secrets legislation, intended to remove liability for any theft of non-trade secrets. Thus, if the proof establishes in a given case that the information that has been allegedly misappropriated constitutes a trade secret, then, it would appear, most courts would hold that common law claims like conversion, would be preempted. In contrast, if the facts established the theft of non-trade secrets, then the statutory claim under the state trade secrets act would not preempt a claim of conversion based upon the taking of information that, though not a trade secret, was nonetheless of value to the plaintiff. Judge Golden's opinion collects the authorities on this interesting issue.

Cases holding that trade secrets acts preempt common law tort claims:

- *Bliss Clearing Niagra, Inc. v. Mmidwest Brake Bond Co.*, 270 F. Supp. 2d 943 (W.D. Mich. 2003);
- *Mrtg. Specialists, Inc. v. Davey*, 904 A.2d 652 (N.H. 2006);

- *Ethypharm S.A. France v. Bentley Pharms., Inc.*, 388 F. Supp. 2d 426 (D. Del. 2005);
- *Auto Channel, Inc. v. Speedvision Network, LLC*, 144 F. Supp. 2d 784 (W.D. Ky. 2001);
- *Thomas & Betts Corp. v. Panduit Corp.*, 108 F. Supp. 2d 968 (N.D. Ill. 2000)
- *Polar Molecular Corp. v. Amway Corp.*, No. 1:07-cv-460, 2007 WL 3473112 (W.D. Mich. Nov. 14, 2007)

Cases holding that trade secrets acts do not preempt common law tort claims:

- *Roger Dubois N. Am., Inc. v. Thomas*, 2006 U.S. Dist. LEXIS 65674 (M.D. Pa. Sept. 14, 2006);
- *Callaway Golf Co. v. Dunlop Slazenger Group Ams., Inc.*, 295 F. Supp. 2d 430 (D. Del. 2003) (interpreting and applying California law)
- *Stone Castle Fin., Inc. v. Friedman, Billings, Ramsey & Co.*, 191 F. Supp. 2d 652 (E.D. Va. 2002);
- *S&S Computers & Design, Inc. v. Paycom Billing Servs.*, 2001 U.S. Dist. LEXIS 25874 (W.D. Va. Apr. 5, 2001);
- *Combined Metals of Chicago, Ltd. v. Airtek, Inc.*, 985 F. Supp. 827 (N.D. Ill. 1997);
- *Burbank Grease Servs., LLC v. Sokolowski*, 717 N.W.2d 781 (Wis. 2006).

XXIX. COUNTERCLAIMS IN TRADE SECRETS LITIGATION

In *Am. Chem. Soc'y v. Leadscope, Inc.*, 2010 Ohio 2725 (Ohio Ct. App. 2010), the Ohio Court of Appeals affirmed a lower court's refusal to reduce a jury award of $26.5 million. In *Leadscope*, the plaintiff sued defendant for, among other things, misappropriation of trade secrets. In response, defendants filed counterclaims for defamation, tortious interference with business relations, unfair competition, violations of the Ohio Deceptive Practices Act, and violations of the Ohio Pattern of Corrupt Activities statute. At trial, the jury found for defendant, and awarded defendant $26.5 million in compensatory and punitive damages. This award was upheld on appeal, but is currently on appeal to the Ohio Supreme Court.

XXX. TRADE SECRETS AND NON-COMPETITION

The Virginia Supreme Court recently passed on the question of whether the Virginia Uniform Trade Secrets Act, Va. Code § § 59.1-336 *et seq.* protects trade secrets from use by an entity which is *not* in competition with the plaintiff. In *Collelo v. Geographic Servs., Inc.*, Nos. 101411, 1014214, 2012 Va. LEXIS 12 (Va. Jan. 13, 2012) the Virginia Supreme Court was faced with a situation in which plaintiff, a firm which provided, among other services, work related to "geonames" to its clients, had one of its employees hired away by a client. The employee was hired by the client to perform substantially the same work to the client that he had provided as an employee of plaintiff – namely, work related to "geonames." As a result of this, the defendant-former employee's new employer demanded a reduction in rates and hours on the "geonames" work that plaintiff performed for it.

Plaintiff brought suit, alleging, among other things, that defendant and defendant's employer had breached the Virginia Uniform Trade Secrets Act. The trial court dismissed this claim with prejudice, finding that the purpose of the act was to prevent competitors, not clients, from gaining access to trade secrets. Finding that there was no loss of business by plaintiff, or gain in income by defendant, the court determined that plaintiff had suffered no compensable damages.

Interpreting the language of the Virginia Uniform Trade Secrets Act, the Virginia Supreme Court reversed. The Supreme Court found that "the Trade Secrets Act does not require that one who is accused of misappropriating a trade secret use the allegedly misappropriated trade secret to compete with the holder of the trade secret…all that [plaintiff] was required to show in order to recover against [defendant]…was that [defendant] disclosed [plaintiff's] trade secret without [plaintiff's] consent" and that plaintiff had reason to know at the time of disclosure that he had a duty to keep such information secret. Finally, plaintiff had to show that it suffered damages and was entitled to relief. The court declined to pass on whether plaintiff had sufficiently alleged that it had been damaged.

XXXI. MISAPPROPRIATION OF TRADE SECRETS AS BASIS FOR THE INTERNATIONAL TRADE COMMISSION BARRING THE IMPORTATION OF GOODS

In *TianRui Group Co. v. Int'l Trade Comm'n*, 661 F.3d 1322 (Fed. Cir. 2011), the Court held that the ITC has that authority to apply domestic trade secret law to conduct that occurred in China, and thus, pursuant to § 337 of the 1930 Tariff Act, the Commission may prevent the entry of goods into the United States when it has found "[u]nfair methods of competition [or] unfair acts in the importation of those goods."

XXXII. A JUDICIAL COMMENT ON THE PROTECTION OF BUSINESS SECRETS

In *Keener v. Covergys Corp.*, 205 F. Supp. 2d 1374 (S.D. Ga. 2002), Judge Edenfield in concluding an opinion holding a non-compete covenant to be unenforceable under Georgia law, stated:

> "Although the result reached here is required by Georgia law, it nevertheless presents an unfortunate clash between the core values enshrined in fundamental contract law versus judicial and legislative choices governing the free flow of commerce. Restrictive covenants have been around for ages. They offer intellectual property owners protection against theft and dilution by others. They encourage investment and expand business opportunities. Society is served by the expansion of commerce and the prosperity it brings.
>
> As noted, Keener admits he became privy to confidential information. But a fair reading of recent Georgia appellate decisions leads to the conclusion that employers within and without this State are, in many respects, powerless to protect

> business secrets. Judges are not endowed with business acumen, and a lot of the line drawing required in this field necessitates same. Whether and when a better line should be drawn in cases like this is perhaps best left to legislators, not judges."

205 F.Supp.2d at 1383 (footnote omitted).

NON-SOLICITATION COVENANTS

I. LEGITIMATE INTERESTS TEST

a. General Legitimate Interests Test

In *ManTech Int'l Corp. v. Analex Corp.*, 75 Va. Cir. 354 (Va. Cir. Ct. Fairfax County July 18, 2008) the court struck down the employee's non-solicitation clause, which stated that the employee "shall not directly or indirectly solicit or induce any employees" of the employer's employees to leave the employer. Specifically, the court stated:

> "The phrase 'solicit or induce' conceivably covers situations similar to the allegations of the Complaint where one employee convinces another employee to take a job with a competitor. However, other imaginable scenarios include, but are not limited to, those circumstances in which one employee convinces another to retire early, join the military, or move to another state. A clause of this nature is not narrowly tailored to protect a legitimate business interest."

Whether or not a non-solicitation clause is limited to protecting the employer's legitimate interests is also impacted by the relationship between the employee and the customers which the clause restrains the employee from soliciting. Many courts, for example, disfavor agreements which restrict employees from dealing with *all* clients of their former employer, rather than just those whom they had personal contact with. *Severn Mktg. Assocs., Inc. v. Doolin*, No. CCB-09-3295, 2010 U.S. Dist. LEXIS 102992 (D. Md. Sept. 29, 2010); *Holloway v. Faw, Casson Co.*, 552 A.2d 1311 (Md. Ct. Spec. Apop. 1989). In *Doolin*, the court noted that such agreements are "disfavored" but have been upheld by Maryland courts "so long as the restriction is reasonable when considering all the facts and circumstances." The court went on to explain that to make such a showing, defendant would have to establish that "there were at least some [clients] with whom she did not have direct contact while employed by [plaintiff]." Accordingly, the court reserved this issue for determination on summary judgment.

b. Oklahoma Limits The Breadth of Non-Solicitation Covenants

In *Howard v. Nitro-Lift Techs., LLC,* 2011 Okla. LEXIS 107 (Okla. Nov. 22, 2011), the Oklahoma Supreme Court clarified an earlier ruling allowing for the limited enforcement of non-solicitation covenants, by holding that a non-solicitation covenant may only restrict an employee's solicitation of "established" customers. Thus, a covenant which bars solicitation of all past customers presumably would be deemed to be overbroad in Oklahoma. The opinion also disapproved of the undefined term "customer," stating that it "might stretch to encompass temporary or single-event relationships."

c. Prohibition Against Contact or Accepting Referrals From Prior Employers' Customers Unenforceable

In *Think Tank Software Dev. Corp. v. Chester, Inc.*, 946 N.E.2d 89 (Ind. Ct. App. 2011), the court upheld a provision barring solicitation of the former employers' current or recent customers for a two-year period, without any geographic limitation, but declined to enforce a provision prohibiting any "contact with" such customers, and forbidding acceptance of "referrals of" them.

II. REASONABLENESS TEST

In *Renaissance Nutrition, Inc. v. Jarrett*, 2012 U.S. Dist. LEXIS 2490 (W.D.N.Y. Jan. 9, 2012), several employees left Plaintiff to form a competing venture, and then hired several of plaintiff's employees. The Court, noting sparse authority enforcing non-recruitment covenants, applied the "overriding requirement of reasonableness" used in non-compete causes, and required plaintiff to make an "enhanced" showing that its interests in protecting its investment in client relationships outweighed defendant's interests in free competition. This showing focused on the risk that customers would follow defendants, that the defendants would engage in competition with plaintiff, and that plaintiff's investment in customer development made it "unfair" to allow the defendants to steal its customers to compete with it. While the District Court eventually found for plaintiff and allowed the suit to proceed, such an enhanced requirement carries with it the potential to derail poorly supported cases before they get off the ground.

III. SOLICITATION REQUIRES THE INITIATION OF CONTACT

In *Mona Elec. Group, Inc. v. Truland Serv. Corp.*, 56 F. App'x 108 (4th Cir. 2003) the Fourth Circuit, applying Maryland Law, found that the "plain meaning of 'solicit' requires the initiation of contact." In *Mona Electric*, plaintiff had sued for tortious interference with economic relations. To be liable for tortious interference with economic relations in Maryland, a party must either induce the breach or hinder performance of the contract. The contract in question was a non-compete agreement signed by Mr. Gerardi, a former employee of plaintiff, which prohibited him from "attempt[ing] to solicit any of [plaintiff's] customers for himself or for any other electrical or technology contract." It is this contract with which plaintiff alleged that defendant, Mr. Gerardi's current employer, had interfered. The Fourth Circuit noted that, for defendant to be held liable, plaintiff must show that defendant had induced Mr. Gerardi to "solicit" customers or had hindered his non-solicitation obligations.

Agreeing with the lower court, the Court of Appeals held that solicitation requires the initiation of contact. The court further held that merely submitting estimates to plaintiff's customers does not fall within the plain meaning of "solicit" – explaining that "if [plaintiff] intended to prevent Gerardi from conducting business with its customers it could have easily stated that in the agreement."

IV. Anti-Raiding and Law Firms

Courts will generally enforce contractual agreements between a company and its employees restricting their ability to "raid" the company's employees after termination so long as they are supported by consideration. *See Lane Co. v. Taylor*, 330 S.E.2d 112 (Ga. Ct. App. 1985) (approving covenant but requiring consideration). However, public policy may sometimes place limits on such covenants. In *Jacob v. Norris, McLaughlin & Marcus*, 607 A.2d 142 (N.J. 1982), the court addressed such a situation. In *Jacob*, the defendant lawfirm had reduced a departing partner's compensation when he took clients of that firm with him. The court, citing the Rules of Professional Conduct, held that the "more lenient test used to determine the enforceability of a restrictive covenant in a commercial setting is not appropriate in the legal context." *Id.* at 27 (internal citations omitted). Instead, the court held that while it was permissible to account for the "actual financial impact of a partner's move, if made realistically" it was not permissible to "penalize the lawyer's choice" as such would "constitute a restriction on the practice of law prohibited by [Rule 5.6 of the Rules of Professional Conduct]." *Id.* at 30. *See also* Stephen E. Kalish, *Covenants Not to Compete and the Legal Profession,* 29 St. Louis U. L.J. 423 (1985); Comment, *Barefoot Shoemakers: An Uncompromising Approach to Policing the Morals of the Marketplace When Law Firms Split Up*, 19 Ariz. L.J. 509, 534 (1987).

V. Passive Solicitation on the Internet

In *Amway Global v. Woodward*, 744 F. Supp. 2d 657 (E.D. Mich. 2010), the federal district court for the Eastern District of Michigan had to determine whether blog posts could constitute actionable solicitation. In *Woodward*, defendant-former "independent business owners" affiliated with plaintiff had terminated their affiliation but remained in contact with each other. Defendants were restrained from "encourag[ing], solicit[ing], or otherwise attempt[ing] to recruit or persuade any other IBO to Compete with the business of the Corporation." On appeal from an arbitral decision in favor of plaintiffs, defendants argued that their posts to the internet did not violate this restriction because they were "passive, untargeted communications [that] fail as a matter of law to qualify actionable solicitations." For example, one defendant had made a post which read "[i]f you knew what I knew, you would do what I do." Plaintiff relied on this and similar blog posts to show that the defendants had engaged in improper solicitation.

The court, in affirming the arbitral award, noted that "communications qualifying as solicitations do not lose this character simply by virtue of being posted on the Internet." In so holding, the court relied on the holding of the Ninth Circuit in *United States v. Pirello*, 255 F.3d 728 (9th Cir.

2001) in which the court found that posting a classified ad on the internet constituted "mass marketing" even though only three people responded to the ad. The court in *Woodward* endorsed the reasoning of the Ninth Circuit, and found unpersuasive plaintiff's argument that the "passive placement of an advertisement on an Internet website devoted to the purpose should not qualify as solicitation because it did not entail one-on-one importuning and was not directed at specific individuals." *Woodward*, 744 F. Supp. 2d at 674 (internal quotations omitted), *See also Neways Inc. v. Mower*, 543 F. Supp. 2d 1277 (D. Utah 2008) (solicitation encompasses more than explicit one-to-one exhortations).

VI. Breach of Fiduciary Duties and Non-Solicitation

a. Generally

An employee may breach his or her duty of loyalty by soliciting the customers or employees of his former employer to join a competing enterprise. *See Hill v. Names & Addresses, Inc.*, 571 N.E.2d 1085 (Ill. App. 1991); *ABC Trans Nat'l Trasnp., Inc. v. Aeronautics Forwarders, Inc.*, 379 N.E.2d 1228 (Ill. App. 1978); *Bancroft-Whitney Co. v. Glen*, 411 P.2d 921 (Cal. 1966). The question faced in cases of this sort is whether an employee's comments were simply a discussion of future plans or pre-termination solicitations. Regardless of their intent, employees should be cautious when discussing future employment with co-workers and clients at their current employer. This is especially true given that solicitation is often defined broadly to include all communications which might be intended to suggest that the client or employee accompany the departing employee to their new job. This is particularly true where the employee is in a position of authority in regards to the client or customers he or she is communicating with. *See Gibbs v. Breed, Abbott & Morgan*, 271 A.D.2d 180 (1st Dep't 2000).

If an employer is harmed by a an employee's breach of his or her fiduciary duties, the employer may be able to recover compensation rendered to the employee during the period of disloyalty. *See Lamdin v. Broaday Surface Adver. Corp.*, 272 N.Y. 133 (1936). A more detailed discussion of this sort of potential recovery is included in: Robert B. Fitzpatrick, *Faithless Servant Doctrine: Employer's Right to Recover Compensation from Disloyal Employees*, cite online at http://www.robertbfitzpatrick.com/papers/FaithlessServantDoctrine.pdf (accessed February 24, 2012).

b. Pre-Termination Notification of Departure

The duty of loyalty usually applies to prohibit pre-termination solicitation of co-workers to join a competing business. *Md. Metals, Inc. v. Metzner*, 382 A.2d 564 (Md. 1978). This is true even in the case of an at-will employee who otherwise has no duty not to compete and has not signed a covenant not to compete. *Vigoro Indus., Inc. v. Crisp*, 82 F.3d 785 (8th Cir. 1996). In *Virgoro*, the Eighth Circuit found that, under Arkansas law, there was a "careful balance" between an employer's right to loyalty from its employees and the employee's right to resign and compete with the employer. The court first noted that "[e]ven corporate officers and directors…are free to resign and go into competition, so long as they remain loyal prior to resigning." *Id.* at 788. Here, however, the court found that defendant had breached his duty of loyalty in two ways: 1) his pre-termination activity "crossed the line from simple notification to an active solicitation"; and 2) defendant interfered with plaintiff's relations with its employees by securing commitments from them to join him at a competing venture. *Id.* at 788-89. Other courts have also found that pre-termination solicitation of employees generally constitutes a breach of the employee's duty of loyalty. *See McCallister Co. v. Kastella*, 825 P.2d 980 (Ariz. Ct. App. 1992); *Thomas Weisel Partners LLC v. BNP Parabas*, No. C 07-6198 2010 WL 1267744 (N.D. Cal. Apr. 1, 2010); *Jet Courier Serv., Inc. v. Mulei*, 771 P.2d 486 (Colo 1989); *News Am. Mktg. In-Store, Inc. v. Marquis*, 862 A.2d 837 (Conn. App. Ct. 2004).

However, after departure a former employee may generally solicit his former co-workers, absent a contractual obligation preventing him from doing so. *See Diodes, Inc. v. Franzen*, 67 Cal. Rptr. 19 (Cal. Ct. App. 1968); *Electronic Assocs., Inc. v. Automatic Equip. Dev. Corp.*, 440 A.2d 249 (Conn. 1981); *Boyce v. Smith*, 580 A.2d 1382 (Pa. Super. Ct. 1990).

Furthermore, mere pre-termination *notification*, as opposed to solicitation, that the employee will be departing and informing her co-workers of her future plans is permitted. In *Feddeman & Co., C.P.A., P.C. v. Langan Assocs., P.C.*, 530 S.E.2d 668 (Va. 2000), the Virginia Supreme Court – reviewing the lower court's grant of a Motion to Strike and to Set Aside the Verdict – first noted that the employee was entitled to "make arrangements to resign, including plans to compete" and that "such conduct would not ordinarily result in liability for breach of fiduciary duty." However, the Supreme Court found that, when defendants' informed other employees of their impending resignation, told them that the other employees could join them at their new employer, and provided resignation letters for those employees to use, then there was sufficient evidence to support the jury's determination that the defendants "did more than prepare to leave their employment and advise others of their plan."

In contrast, in *Appleton v. Bondurant & Appleton, P.C.*, 68 Va. Cir. 208, 2005 Va. Cir. LEXIS 239 (Va. Cir. Ct. July 5, 2005), the court found that the activities were XX. In *Appleton*, a partner of a law firm discussed with several employees of the law firm the possibility that he would leave the firm and begin a new law firm. Several weeks later, he did just that. Among the many claims in this lawsuit, defendant claimed that plaintiff had breached his fiduciary duties to his former employer by engaging in pre-departure solicitation of employees and clients of his former employer. While noting that at-will employees owe "a fiduciary duty of loyalty" to their employers during employment, that "courts must be mindful that the fact that particular conduct off an employee caused harm to his employer does not establish that the conduct breached any duty to the employer." The court went on to state that "the law will not provide relief to every disgruntled player in the rough-and-tumble world comprising the competitive marketplace[.]" *Id.* (internal citations and quotations omitted). Ultimately, the court held that Plaintiff's after-hours discussions, away from his employer's place of business, of the possibility that he would form a new law firm provided insufficient evidence to support a claim for breach of fiduciary duty. *See also McCallister Co. v. Kastella*, 825 P.2d 980 (Ariz. Ct. App. 1992); *Ellis & Marshall Assocs., Inc. v. Marshall*, 306 N.E.2d 712 (Ill. App. Ct. 1973); *Setliff v. Akins*, 616 N.W.2d 878 (S.D. 2000) (all holding that pre-termination notification under various fact patterns did not violate employee's fiduciary duties).

In *FTI Consulting, Inc. v. Graves*, No 05 Civ. 6719, 2007 WL 2192200 at *7 (S.D.N.Y. July 31, 2007), where the defendant informed clients that he was leaving plaintiff firm to join a competitor, the court held that "this act alone cannot be viewed as sufficient to give rise to an inference that he solicited [the plaintiff's] clients and falls short of establishing contravention of the provision not to solicit clients."*But see Ecolab, Inc. v. K.P. Laundry Mach., Inc.*, 656 F. Supp. 894, 896-97 (S.D.N.Y. 1987) (holding that "goodbye notes" informing former clients that the defendants were leaving to join a competitor constituted the "first step in the solicitation" of those clients").

c. Joint Ventures

In *Electronic Assocs., Inc. v. Automatic Eqip. Dev. Corp.*, 440 A.2d 249 (Conn. 1981), plaintiff contended that defendant had breached fiduciary duties which arose from negotiations to form a joint venture. Plaintiff argued that defendant had committed this breach by soliciting plaintiff's employees. While noting that joint ventures "undertake fiduciary duties to each other concerning matters within the scope of the joint venture", the Connecticut Supreme Court found that, the negotiations to form the joint venture had not been shown to be the only basis on which the parties interacted, and so affirmed the lower court's determination that there was no fiduciary relationship. *See also Custard Ins. Adjusters, Inc. v. Nardi*, No. CV 980061967S, 2000 WL 5623187 (Conn. Super. Ct. Apr. 20, 2000).

d. Raiding and "Lift Outs"

In the absence of formal covenants not to compete or solicit employees, employers have attempted to argue that such activity constitutes a breach of the former employee's fiduciary duties – with little success. In *Headquarters Buick-Nissan, Inc. v. Michael Oldsmobile*, plaintiff sued the defendant-former employees for "raiding" its employees. 149 A.D.2d 302 (1st Dep't 1989). Plaintiff focused its arguments on the contention that the solicitation of its employees by defendants while they were still employed by plaintiff constituted a serious breach of fiduciary duty. *Id.* at 303. The Court found this argument unpersuasive, noting that plaintiffs were not bound not to compete or solicit and that, as at-will employees, they were free to engage in such behavior. *Id.* at 303-04. Indeed, the court went so far as to opine that "absent the use of plaintiff's time or facilities, and absent diversion of plaintiff's business, the defendants could have lawfully incorporated a competing business while still employed by plaintiff." *Id.*; *See also Metal & Salvage Ass'n v. Siegel*, 121 A.D.2d 200 (1st Dep't 1986) (free to incorporate competing business prior to departure so long as activity occurs on personal time and without use of plaintiff's assets or trade secrets).

Finally, the court held that "the mere inducement of an at-will employee to join a competitor [is not] actionable, unless dishonest means are employed or the solicitation is part of a scheme designed solely to produce damage". *Id.* In *Lockheed Martin Corp. v. Aatlas Commerece Inc.*, the court faced a similar circumstance when the plaintiff sued defendant-former employee for allegedly soliciting numerous of its employees. 283 A.D.2d 801 (Third Dep't 2001). The court held that "[w]here, as here, the allegations concern at-will employees not bound by covenants not to compete, plaintiff has the high burden of asserting that defendant employed wrongful means, such as fraud, misrepresentation or threats to effect the termination of employment." *Id.* at 803 (internal quotations omitted).

VII. NON-RECRUITMENT CLAUSES AND RESTRAINT OF TRADE

Non-compete clauses in employment contracts are generally not enforceable in California. *See Edwards v. Arthur Andersen LLP*, 189 P.3d 285 (Cal. 2008); Cal. Bus. & Prof. Code § 16600. However, the same cannot be said for non-recruitment/solicitation clauses. In a pre-*Edwards* case, the California Court of Appeals ruled that non-recruitment clauses are not invalidated by Cal. Bus. & Prof. Code § 16600 because they do not create a "significant" restraint on the ability of the former employee to practice his or her trade. *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (Cal. Ct. App. Nov. 8, 1985). The Court found that, at most, such clauses affect the employee's former colleagues insofar as they must contact the employee rather than the other way around. *Id.* A similar result was reached by the federal district court for the Southern District of Texas in *Baker Petrolife Corp. v. Spicer*, 2006 U.S. Dist. LEXIS 41535 (S.D. Tex. 2006). In *Baker Petrolife,* the court held that a non-recruitment clause was not a "restraint of trade" and was thus not prohibited by the state's non-competition statute, found in Tex. Bus. & Comm. Code § 15.05(a). *See also Smith, Barney, Harris Upham & Co., Inc. v. Robinson*, 12 F.3d 515 (5th Cir. 1994) (applying a similar Louisiana statute and finding that it did not significantly restrain trade).

Other California courts have disagreed with this interpretation. For example, in *VL Systems Inc. v. Unisen Inc.*, 152 Cal. App. 4th 708 (2007), the California Court of Appeals found that a broad "no-hire" provision in a consulting agreement was unenforceable under Cal. Bus. & Prof. Code. § 16600. In *VL Systems*, plaintiff, seeking enforcement of the no-hire clause, argued that "this case has absolutely nothing to do with an [e]mployee's freedom of movement or covenants not to compete between employer and employee…[t]he subject contract did not 'preclude' [defendant] from hiring [one of plaintiff's employees]…[r]ather, the contract simply called for the payment of a fixed sum to VLSystems should they chose to do so." The court disagreed, holding that § 16600 permits a competitor to "solicit another's employees if they do not use unlawful means or engage in acts of unfair competition." *VL Systems*, 152 Cal. App. 4th at 713 (quoting *Metro Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853 (1994)). While noting that courts "should not blithely apply public policy reasons to void contract provisions" the court went on to explain that "[t]his type of contractual provision, however, may seriously impact the rights of a broad range of third parties."

The court distinguished *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (Cal. Ct. App. Nov. 8, 1985) based on the fact that the employee (a third party) chose to apply on his own initiative, without any active recruitment by defendant. All these facts combined to persuade the court that this broad no-hire contract was unenforceable.

However, not all states are in accord with this interpretation. For example, in *Marsh & McLennan Cos. v. Palmer & Cay, Inc.*, 404 F.3d 1297 (11th Cir. 2005). The 11th Circuit held that a non-solicitation agreement between an insurance executive and his former employer, which prevented executive from accepting unsolicited business from former clients of his former employer, is invalid and unenforceable under Georgia law because the state's courts refuse to enforce employment non-competition agreements that bar employee from accepting unsolicited business from former clients after leaving employment. Because Georgia does not attempt to limit its declaratory judgments in cases involving such non-competition agreements declaratory relief cannot be limited to that state under principles articulated in *Semtek Int'l, Inc. v. Lockheed Martin Corp.*, 531 U.S. 497 (2000), that under federal common law, enforcing court should apply law of state courts in state where rendering federal court sits, unless state's law conflicts with federal interests. Other courts hold that if there is no solicitation of the customer, it is unreasonable to prevent a customer from following an employee to the employee's new employer. *Prudential Sec., Inc. v. Plunkett*, 8 F. Supp. 2d 514, 519-20 (E.D. Va. 1998).

VIII. CALCULATION OF DAMAGES FROM SOLICITATION

Though the scale of the solicitation is not, in and of itself, sufficient to give rise to a claim for breach of the duty of loyalty, large-scale solicitation is certainly relevant to the calculation of damages. *See Veco Corp. v. Babcock*, 611 N.E.2d 1054 (Ill. App. Ct. 1993).

In *Vigoro Indus., Inc. v. Cirsp*, 82 F.3d 785 (8th Cir. 1996), the Eighth Circuit addressed the proper calculation of damages from improper solicitation of a company's employees in breach of defendant's duty of loyalty. In *Vigoro*, the lower court had awarded $75,000 for this breach. In *Vigoro*, the lower court had found that defendant had (successfully) solicited defendant's entire workforce to join a competing venture with him prior to his departure from defendant. In assessing damages, however, the district court focused only on "the harm caused immediately after [defendant's] departure by his pre-resignation soliciting." *Id.* at 789. The Court of Appeals affirmed, noting that the lower court was "clearly correct" to reject the lost-profit theories for calculating damages advanced by plaintiffs which, according to the Court, "irrationally attributed all of Vigoro's competitive losses to the fact that [defendant] had jumped the gun by three weeks in soliciting [plaintiff's] employees and customers." Noting that the determination of damages for three weeks of wrongful solicitation was difficult, the Court affirmed the district court's determination, finding that it was not "clearly erroneous." *Id.*; *See also Sunbelt Rentals, Inc. v. Head & Engquist Equip., LLC*, 620 S.E.2d 222 (N.C. Ct. App. 2005); *Morgan's Home Equip. Corp. v. Martucci*, 136 A.2d 838 (Pa. 1957); *Feddeman & Co., C.P.A., P.C. v. Langan Assocs., P.C.*, 530 S.E.2d 668 (Va. 2000).