

Non-Compete Agreements: Do They Work?

by Anne Greenwood Brown, Esq.

Most people think of competition as a good thing. We ask, "What's wrong with a little healthy competition?" and we recognize it as the cornerstone of capitalism. Regardless, employers are constantly trying to rein in the amount of competition in the marketplace by restricting former employees from working for their competitors.

Courts generally subscribe to the healthy-competition mantra, frown upon unreasonable restraints on trade, and scrutinize contract language that infringes upon a person's ability to work. Some states have gone so far as to declare Non-Compete Agreements void and unenforceable with only limited exceptions for the sale of good will and dissolution of partnerships. See, e.g., Cal. Bus. & Prof. Code § 16600; Mont. Code Ann. § 28-2-703; N.D. Cent. Code § 9-08-06; and Okla. Stat. § 217.

This all begs the question: Do Non-Compete Agreements actually work?

Defining Our Terms: Non-Compete, Non-Solicitation and Non-Disclosure Agreements:

The standards I am about to set out are the standards for Non-Compete Agreements (NCAs), specifically. An NCA is a contract by which an employee agrees not to engage in certain activities that harm the employer's legitimate business interests for a certain period of time, in a certain geographic area.

By comparison, a Non-Solicitation Agreement prohibits an employee from soliciting clients away from the employer and a Non-Disclosure Agreement prohibits an employee from disclosing an employer's confidential information or trade secrets. While these two agreements are often used in conjunction with an NCA, on their own, they typically do not restrict the employee from working for a competitor.

Now that we know our terms, how can an employer ensure that its NCA will stand up to the court's scrutiny? There is no 100% guarantee. The best an employer can do is be aware of the standards and not push the envelope too far.

Legitimate Business Interest:

In Minnesota and Wisconsin, NCAs are only enforceable to the extent they protect a legitimate business interest. Wis. Stat. § 103.465; *Kallok v. Medtronic, Inc.*, 573 N.W.2d 356 (Minn. 1998); *Bennett v. Storz Broadcasting Co.*, 134 N.W.2d 892 (Minn. 1965); *Chuck Wagon Catering v. Raduege*, 277 N.W.2d 787 (Wis. 1979). Courts will look to see that the agreement is not any broader than necessary to protect the stated interest. There are certain accepted legitimate business interests, among them: (1) protecting against the deflection of trade; (2) protecting confidential business information and trade secrets; and (3) protecting customer goodwill. If the employer can articulate a legitimate business interest, *and show that the employee is a key employee who will have access to the protected information*, it has passed the first test. What remains is whether the

scope of the time and territory limitations is reasonable and connected to the business interest.

Duration:

An employer cannot impose an NCA forever. *Saliterman v. Finney*, 361 N.W.2d 175 (Minn. Ct. App. 1985); see also *Chuck Wagon Catering*, 277 N.W.2d at 751 (stating the Wisconsin requirement that the time period must be reasonable). Time restraints must also be tied to the threat of competition. For example, the duration must be reasonable in light of the nature of the work, the time necessary to train new workers, the time necessary to allow customers to become familiar with new employees, and the time necessary for customers to obliterate their identification of the employee and the employer as related persons.

So what time duration is reasonable? There is no one answer. One-to-three years is typical, but will only pass muster if the circumstances warrant. A one-year duration has been struck down in the IT industry, for example, because “in the Internet environment, a one-year hiatus from the workforce is several generations, if not an eternity.” *Earthweb v. Schlack*, 71 F. Supp.2d 299, 316 (S.D.N.Y. 1999).

Territory:

An employer cannot impose an undue hardship on its former employee, and unlimited territorial restrictions are generally unenforceable. *Saliterman v. Finney*, 361 N.W.2d 175 (Minn. Ct. App. 1985); see also *Chuck Wagon Catering*, 277 N.W.2d at 751 (stating the Wisconsin requirement that the restricted territory must be reasonable). Also, like the time duration, the territory must be connected to the legitimate business interest. For example, the employer must actually do business within the territory, or the employee must have actually performed duties within that territory. There are, of course, exceptions.

While the absence of a territorial limitation is a genuine concern in many cases, the absence of a limitation does not make the agreement unenforceable *per se*. Multinational corporations, for example, may not require a territorial limit.

Another recent exception has developed with the growth of the internet marketplace, but just because an employer could *conceivably* have customers anywhere in the world, does not automatically get it past the No Undue Hardship Rule. One way to deal with this is to prohibit the former employee's contact with certain named, nationwide customers, rather than within the geographic territory itself. *IDS Life Ins. Co. v. SunAmerica, Inc.*, 958 F. Supp. 1258 (N.D. Ill. 1997), *rev'd on other grounds*, 136 F.3d 537 (7th Cir. 1998) (applying Minnesota law).

As a side note, it is more than just working within the territory that can violate an NCA. In *Sealock v. Peterson*, 2008 WL 314146 (Minn. Ct. App. Feb. 5, 2008), the court held that a former employee who started working *outside* the restricted territory had violated the NCA by *advertising* within the restricted territory.

Adequate Consideration:

Finally, in Minnesota, an NCA is invalid if it does not have adequate and independent consideration. Ideally, an NCA is presented to a potential employee at the time the employment starts because only then will the commencement of employment be treated as the consideration. Best business practices would dictate that the NCA is signed at the same time as the W-4.

When the NCA is added mid-stream, even if very soon after employment commenced, there must be new and independent consideration. An employer who merely notifies the employee about the NCA but does not make it part of the deal before the employee begins work, must usually provide separate independent consideration to make it enforceable. *Davies & Davies Agency, Inc. v. Davies*, 298 N.W.2d 127 (Minn. 1980).

Continuation of employment is generally not considered adequate consideration. Furthermore, the consideration must be a real benefit and not something to which the employee is already entitled. For example, consideration could be a salary increase, a bonus, an increase in responsibility, or a promotion. For these mid-stream benefits to be deemed adequate consideration, they must be presented to the employee at the same time as the NCA. Finally, there must be a distinction between the benefits given to those who sign the NCA and those who do not. *Davies & Davies Agency, Inc. v. Davies*, 298 N.W.2d 127 (Minn. 1980).

Adequacy is determined on a case-by-case basis. On the issue of “adequacy,” the consideration must be bargained for and provide a real advantage. It does not have to be a small fortune. In *Tenant Construction Co. v. Mason*, 2008 WL 314515 (Minn. Ct. App. Feb. 5, 2008), five hundred dollars was deemed adequate consideration because the employee agreed to it. The court rationalized that the employee considered it adequate consideration because he could have negotiated for something more but did not.

In Wisconsin, consideration is not mentioned as one of the required factors in *Chuck Wagon Catering*, or the cases that follow. However, consideration is a basic principle of contract construction and it is at least mentioned in a few Wisconsin NCA cases. See *Medrehab of Wis., Inc. v. Johnson*, 578 N.W.2d 208 (Wis. Ct. App. 1998) (finding that the NCA was supported by consideration); *Pritchard v. Mead*, 455 N.W.2d 263 (Wis. Ct. App. 1990) (finding employee was offered a five-year employment contract, salary increase, and bonuses as consideration for a six-year NCA); *Endlich Packing Co. v. Elliott*, 289 N.W.2d 373 (Wis. Ct. App. 1979) (finding that NCA had a blank space for insertion of a figure representing consideration paid for the agreement not to compete). For these reasons, Wisconsin employers are strongly advised to follow the Minnesota parameters set forth above.

In conclusion, employers can have faith in their NCAs so long as they are (1) written narrowly to protect articulated and legitimate business interests, (2) imposed on only those key employees who have actual access to the protected information, (3) applied only to a reasonable time period and geographic territory, and (4) supported by

adequate and independent consideration. For more information, or to inquire into the drafting of an NCA for your employees, please contact Anne Greenwood Brown at (651) 738-3433.