"Should I Stay or Should I Go?" - Covenants Not to Compete in a Down Economy

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“Should I Stay or Should I Go?”-- Covenants Not to Compete in a Down Economy: A Proposal for Better Advocacy and Better Judicial Opinions

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Introduction

Suppose an employee assents to a covenant not to compete in exchange for a job. The formation of this “contract” is unexceptionable and one would suppose that ordinarily the employee ought to be bound by her promise. But suppose that, between the formation of the covenant and a dispute over enforcement of the covenant, the employer’s business deteriorates and the employer begins to squeeze the employee to work harder or take a cut in benefits. Should the squeeze be irrelevant if the employee eventually decides to quit and tries to take a job within her field that’s barred by the terms of the covenant? Should the employer always be able to state a claim for breach of contract?

This article is an effort to think about that question from a theoretical and practical standpoint. Employee covenants not to compete generate a lot of legal disputes perhaps, in part, because they often bite when an employment relationship is already on the rocks and then they extend their restraints out past the time of any productive exchange between the parties. Employee covenants not to compete also generate scores of academic articles because there are always new cases to write about and because covenants dwell on a fault line that runs between freedom of contract and substantive control over contract. Yet, despite all the judicial and academic scrutiny over many decades there’s not much consensus among states or scholars about how, or if, these covenants should be regulated. It seems to me, however, that there are relatively productive and unproductive ways to argue about the issues, and that many lawyers and state courts are so hobbled by inherited arguments that contemporary judgments may be neither efficient nor fair or even likely to forestall later lawsuits. This article is an effort to bridge some of the gap between theory and practice with a tilt toward being useful to practitioners and judges by examining specifically how arguments are actually constructed in terms of state statutes and precedents.

Substantively, this article provides state appellate courts and legal counsel with a rationale for minimizing the enforcement of covenants not to compete where the
assenting employee lacks significant bargaining power while preserving employers’ abilities to enforce these covenants against employees who enjoy such power. Bargaining power is correlated with at-will employment status, and a remarkable number of cases involve disputes over the propriety of covenants in that context. My particular goal is to help counsel and state appellate courts articulate good reasons for relieving some employees at-will of the restraints of covenants they signed voluntarily without resorting to economically and psychologically factitious holdings that such employees received no legally sufficient consideration. My hope is that better-reasoned opinions will foster better contracting and litigation strategies and those, in turn, will generate fewer disputes and fairer, more predictable outcomes when disputes are unavoidable.

Part I sets out my proposal and the legal and economic arguments for it. Part 2 summarizes the major approaches to regulating employee covenants not to compete in the 50 states and discusses the prevailing legal and economic analyses from the academic literature. Part 3 applies the proposal in a detailed critique of the litigation strategies and arguments that resulted in a 2004 opinion from the Washington Supreme Court. The case provides, in my view, a particularly vivid illustration of how this kind of dispute ought not to be argued or decided – but often is. Washington follows the basic common law “rule of reason” in regulating covenants and, because most states (though not all) have adopted some variation on that rule, Washington’s experience provides useful lessons beyond its jurisdiction. Part 3 concludes with a comparison of how several other state courts have handled similar disputes during the past decade or so – some more forthrightly than Washington, but none ideally. I hope that Part 3 will make it clear to judges and counsel how my proposal might be used in practice.
Part 1

What should be the legal significance of an employee’s signed assent to a covenant not to compete with an employer? 2

In most states in the United States, the basic answer3 is that this assent is evidence of a contractual obligation. As a result, an employer can state a claim for breach of contract upon alleging acts that violate the covenant’s terms, and that claim will likely survive pre-trial motions to dismiss or for summary judgment, unless the employee can establish an affirmative defense such as a failure of consideration or that the terms are so overbroad on their face that they plainly violate public policy. Absent a successful affirmative defense, the employer may be able to secure a temporary injunction to preserve the status quo. If the case is not settled first, the final judgment and any remedy

2 Aspects of my analysis may be pertinent to other, usually narrower, restraints on employees’ post-employment activities, depending upon how they are worded, but for reasons of clarity and brevity I use the generic term “covenant not to compete” in the text except where the distinctions are important to my argument. Those narrower restraints include documents or clauses in documents in which an employee promises not to disclose certain kinds of information after an employment (usually called “non-disclosure agreements”) or in which the employee promises not to solicit, and sometimes not to service, customers or sometimes suppliers of a former employer (usually called “non-solicitation agreements”). Some agreements also prohibit soliciting employees of the former employee. Like covenants not to compete, all these clauses restrain an employee from engaging in activities after the employment ends that the employer defines as harmful to its competitive advantage.

These clauses are not neatly distinguishable from one another. Documents labeled as covenants not to compete frequently include not only a clause prohibiting competition but also clauses prohibiting disclosure or solicitation or service of former customers. Each of these clauses may be drafted broadly or narrowly. Thus, the name of a document or clause may not be a reliable guide to its effect. The operative language of the particular clause is the only determinant of meaning. For an introduction to the various clauses and their purposes, see Laurence H. Reece & Jay Shepherd, Employer NonCompetition Agreements, in Massachusetts Employment Law, Vol. I, Chap 20, §§ 20.3.2., 20.3.5., 20.3.6. (Massachusetts Continuing Legal Education, Inc. 2008), available at ELII MA-CLE 20-1 (Westlaw).

Rhetorically, covenants not to compete seem more troublesome than non-disclosure and non-solicitation agreements because they prohibit competition per se and thus seem to interfere more directly with a former employee’s liberty. In contrast, non-disclosure and non-solicitation agreements seem to restrain the use of assets that are conceptually or perhaps only semantically separable from the brain of the employee. See infra at [Part 2, pp. 25 -28].

3 This answer reflects the common law tradition as it has evolved in the United States. It is consistent with the description in the RESTATEMENT (SECOND) OF CONTRACTS §186 – 188 (1981) and provides a sense of the principles that inform much of the case and statute law in the 48 states that enforce employee covenants not to compete to some degree. It should be noted, however, that the precise rules in any given state may vary considerably from this conventional answer. See infra at [Part 2, pp. 14 -20]
for a proven breach are contingent upon the court’s determination that, as applied in the particular circumstances, the restraints strike a reasonable balance in protecting the employer’s investments, the employee’s livelihood, and the public interest in the fruits of productive competition.

Instead, I propose that evidence of an employee’s assent should not necessarily permit the employer to invoke the procedural and substantive advantages of a claim grounded in contract. Instead, the contractual significance of an employee’s assent to a covenant not to compete should vary from negligible to strict depending upon four factors. It should not turn, as it too often now does, on the presence or absence of a formal, legal consideration.\(^4\)

The first and most important factor is the legitimacy of the employer’s claim that it needs to restrain the employee’s post-employment activities in order to preserve the value of socially desirable investments. The remaining three factors measure the propriety of affording the employer the particular procedural advantages of being able to assert its claim as one for breach of contract. Those factors are: the caliber of the bargaining process that resulted in the employee’s assent to the covenant; the benefits the employee stood to gain and did in fact gain in exchange for the covenant; and the employer’s ability to obtain an adequate remedy for invasion of its legitimate interests by pursuing different claims under public law, such as those provided by trade secret statutes and tort law. In other words, sometimes a covenant not to compete should be treated like a real contract and sometimes not so much.

To the extent that state courts now have discretion to specify burdens of production and proof, they should do so in order to mitigate the burden on the employee of defending a contract claim that may not be meritorious were it to reach trial. The employer ought to


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have the burden to produce clear and convincing evidence for the legitimacy of its business interest if it seeks injunctive relief before a trial on the merits and it should have the burden of proof on this issue if either party moves for summary judgment as well as at trial. I do not think this alters current black letter civil procedure rules. Instead, I offer it as a corrective to some contemporary courts that seem inclined to treat covenants not to compete like run-of-the-mill commercial contracts whose terms are presumptively enforceable as written and to defer serious evaluation of the legitimacy of the employer’s interests until well into the litigation process, if ever.\(^5\)

It will be much more controversial, but I will nonetheless suggest that courts also should require employers to produce evidence relevant to the other three factors. At least when exercising equitable powers in response to an employer motion for injunctive relief, a trial judge ought to evaluate the caliber of the bargaining process, the employer’s management of the employment relation prior to the employee’s alleged violation of the covenant, and the employer’s ability to obtain an adequate remedy for an actual or threatened invasion of its interest under public law doctrines.

The proposed four factor analysis would have the most impact on management, contracting, and litigation practices affecting employees at-will. At present, in the many states that enforce employee covenants not to compete under some variant of the conventional rule described above, a remarkable number of recent cases and legal notes and articles involve the issue of whether continued at-will employment provides legal consideration for an employee’s assent to a covenant not to compete, and there is no consensus about the answer.\(^6\) The logic of both doctrines – employment at will and

\(^5\) See, e.g., cases cited supra note [4].

\(^6\) The issue may be characterized as whether an employment at-will can be consideration for a contract. A closely related issue concerns whether the covenant is ancillary to an enforceable obligation, when it is ancillary to an employment at-will. See, e.g., Richard A. Lord, The At-will Relationship in the 21st Century: A Consideration of Consideration, 58 Baylor L. Rev. 707, 717 (2006) (including references to recent cases with an emphasis on Texas cases, and noting that an initial offer of or hiring into employment at-will suffices for consideration in most states, id. at 729 – 30, and suggesting that courts might be wise to abandon the consideration requirement and focus instead on the legitimacy of the business interest justifying the restraint at whatever stage of the employment the covenant is formed, id. at 717) (hereinafter “Lord/At-Will”); Kathryn J. Yates, Note, Consideration for Employee Covenants in Employments at Will,
When an employer attempts to enforce a covenant that was secured well after an employment commenced, the question of whether continued at-will employment provides sufficient consideration is more controversial. Washington state cases on this issue are discussed in Part 3, infra at pp. __. See also, e.g., Glisson v. Global Sec. Svc., 653 S.E.2d 85, 86 (Ga. App. 2007) (holding that a few months of continued employment after execution of covenant during ongoing employment is not sufficient consideration to render the covenant enforceable and commenting “[i]n the employment context, the consideration required for a covenant not to compete to be enforceable often takes the form of a job opportunity; ‘the employee really gets nothing other than the opportunity to work in exchange for giving up [an aspect of his freedom.’”)(citation omitted)); Ikon Office Solutions, Inc. v. Belanger, 59 F. Supp. 2d 125, 131-132 (D. Mass. 1999) (applying Massachusetts law and finding that a non-compete/non-solicitation agreement signed as a condition for continued employment was not supported by consideration where the employer did not provide a long-term employee with any additional consideration); Collier Cable & Assoc. Inc. v. Leak, 300 S.E.2d 583 (N.C. App. 1983) (holding covenants secured from long-term employee not supported with any new consideration sufficient to support the covenant even though employee remained employed for about eight years after signing the agreement); but cf. Nestle Food Co. v. Miller, 836 F. Supp. 69, 77 (D. R.I. 1993) (finding continued employment sufficient consideration under Rhode Island law); Ins. Assoc. Corp. v. Hansen, 723 P.2d 190, 192 (Idaho App. 1986) (finding sufficient consideration for covenant signed about 20 months of at-will employment where employee faced threat of discharge for not signing). See generally CALLMAN, supra at § 16:41; Yates, supra; Matthew C. Palmer, Note, Where Have You Gone, Law and Economics Judges? Economic Analysis Advice to Courts Considering the Enforceability of Covenants Not to Compete Signed After At Will Employment Has Commenced, 66 Ohio St. L.J. 1105 (2005) (citing cases from around the country and criticizing many decisions for lack of economic realism in the focus on formal consideration); Ferdinand S. Tino, Annotation, Sufficiency of Consideration for Employee’s Covenant Not to Compete, entered into after inception of employment, 51 A.L.R. 3d 825 (1973).

Texas courts have struggled for years with the issue of whether an offer of at-will employment can both provide contract consideration and also satisfy that state’s statutory requirement that an employee covenant be ancillary to some other enforceable obligation that justifies the restraint at the time the covenant is made. Technically, the answer seems to be yes, and no, respectively. But since 1994, when the issues first arose, the Texas Supreme Court has steadily given way on the second point so that, now, an implied promise to give something of value later or the provision of some value at some later date makes the covenant enforceable. See Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding, ___ S.W.3d ___, 2009 WI 1028051

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contract consideration -- is often strained, and I suspect that many trial courts’ willingness to ground judgments on the consideration issue as a matter of law is merely an expedient way for disposing of cases without much fact-finding. It is hard to believe that the diversity of outcomes and rationales in these cases really stem from disagreement about whether promises were made in exchange for some benefit instead of disagreement about the propriety of enforcing certain promises in particular situations. At the appellate level, a legalistic holding on consideration may also serve to camouflage more politically controversial bases for decisions — such as a feeling that an at-will employer’s treatment of an employee is inequitable although not illegal. 7

(Tex. 2009) (holding that a covenant not to compete was supported by consideration and was ancillary to an enforceable obligation on the theory that the employee’s job as an accountant required access to confidential client financial information, the employer had impliedly promised to provide access to that information); Alex Sheshunoff Mgmt Svc., L.P. v. Johnson, 209 S.W.3d 644, 648 - 651 (Tex. 2006) (interpreting Tex. Bus. & Com. Code Ann. §15.50 (Vernon 2002) and holding that although an employee’s covenant given in exchange for initial at-will employment was not enforceable when it was signed because the at-will employer had no enforceable ancillary obligation at that time, the employee’s non-compete promise became a binding unilateral obligation when the employer later provided access to proprietary information that justified the restraint); Shoreline Gas, Inc. v. McGaughey, 2008 WL 1747624 at *5 (Tex. App.) (following Sheshunoff, id., and finding covenant enforceable when employer provided confidential information but holding that employer failed to establish probability of irreparable injury sufficient to warrant injunction); cf. Light v. Centel Cellular Co., 883 S.W.2d 642 (Tex. 1994) (holding that an at-will employee is not bound by a covenant if at the time the agreement was made the employer had no corresponding enforceable obligation to the employee). The state supreme court’s opinions resemble debates about how many angels can dance on the lid of a pin. It seems to me that the courts’ opinions are particularly confusing because, driven in part by the statute’s wording, they conflate the concepts of consideration, ancillary obligation and legitimate business interest. The bottom line seems to be that, in Texas, a covenant given for an at-will employment will be enforceable if and when the employer provides the employee access to something that might be a legitimate business interest. That is not necessarily an unreasonable rule, but it does raise a question about the relevance of contract formation rules. For a detailed discussion of the Texas cases through the 2006 state supreme court decision, see Shana L. Burleson & David R. Clouston, Light Dimmed by Johnson – The Enforceability of Covenants Not to Compete Under Texas Law, 59 Baylor L. Rev. 287 (2007); see also Lord/At-Will, supra.

7 Florida’s legislative response to the perceived misuse of contract rationales by the state courts is interesting in this regard. Florida amended its statute to authorize contracts that restrict competition by ex-employees provided, among other things, that they were signed by the employee and that the employer established a legitimate business interest. The statute omits any requirement of formal contract consideration. FLA. STAT. § 542.335 (1) (West 2002 & Supp. 2007). See John A. Grant & Thomas T. Steele, Restrictive Covenants: Florida Returns to the Original “Unfair Competition” Approach for the 21st Century, 70 Fl.A. BAR. J. 53 - 54 (1996) (explaining the amendment and commenting that “[i]n the late 1970s and throughout the 1980s, the Florida courts lost sight of the original purpose of the statute [to protect the legitimate interests of the employer] and increasingly employed a judicial approach to such agreements that emphasized a ‘contract-oriented’ methodology and that abandoned the original ‘unfair competition’ theory of analysis and enforcement. Although the ‘contract-oriented’ approach seemingly offered a high level of certainty of enforcement, in reality it led to a hodge-podge of conflicting and unprincipled decisions. Specifically, the emphasis upon contract concepts i) provided no principled way for the courts to decline to enforce contractual restrictions upon competition that were not justified by the need

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The real flaw in these decisions is that the consideration issue – no matter how it is resolved – simply doesn’t get at the problems that should concern courts and legislatures about the combination of covenants not to compete and employment at-will. Any minimally alert employer can construct some legally sufficient consideration for a covenant not to compete even if employment at-will is not deemed sufficient. The more important question is whether an employer should be able to construct a contractual duty not to compete based upon an at-will relationship. Insistence on formal consideration risks elevating the symbol of a bargain into the thing itself.

A contract claim is generally the cheapest, simplest and fastest way for an employer to preserve the status quo, and so employers have reason to try to protect their proprietary interests by contract if the courts will oblige. The relative ease with which an employer can state a prima facie case of breach of contract when an employee engages in activities that appear to violate the terms of a covenant – whether or not those terms will ultimately be deemed reasonable – affords an employer considerable leverage. The employer can use the covenant to deter other employers from extending offers of employment by threatening to sue for tortious interference with contract, and the employer can impose significant litigation costs upon the employee simply by filing suit. That leverage is, of

to protect any substantial ‘legitimate business interest’ and ii) lent itself to distortion by result-oriented courts.”); see also N. James Turner, Successfully Defending Employees in Non-compete and Trade Secret Litigation, 28 FLA. BAR J. 43 (2004) (outlining defenses based on the absence of a legitimate business interest or the employer’s “unclean hands” but not mentioning the affirmative defense to contract liability of a failure of consideration, presumably because the statute eliminated it); Kenneth J. Vanko, “You’re Fired! And Don’t Forget Your Non-Compete…”: The Enforceability of Restrictive Covenants in Involuntary Discharge Cases, 1 DEPAUL BUS. & COM. L. J. 1, 26 - 36 (2002) (hereinafter “Vanko”) (commenting that Florida is one of the most “employer-friendly” jurisdictions and criticizing courts for enforcing covenants despite allegations of constructive discharge, see, e.g., Alliance Metals, Inc. v. Hinley, 222 F.3d 895 (11th Cir. 2000) or reduction in commissions, see, e.g., Kupscznk v. Blasters, Inc., 647 So. 2d 888 (Fla. Dist. Ct. App. 1994)). Professor Vanko’s observation is a cautionary counterpoint to my thesis. The Florida statute’s de-emphasis of common law contract principles no doubt made it more difficult for courts to give judgments on non-statutory grounds and so, perhaps, the courts could no longer rationalize outcomes for employees on a common law ground like failure of consideration. I think the more serious problem, however, is that the Florida statute makes it very easy for employers to construct a valid statutory “contract” and to state a prima facie claim, and the Florida courts may be too willing to accept employers’ self-interested definitions of a legitimate interest. Since the statute does not define such an interest, the courts could adopt some of my analysis of that element even within their discretion under the statute.

8 See, e.g., Labriola v. Pollard Group, Inc. 100 P.3d 791, 793 (Wash. 2004).
course, the reason that employers want to add contractual claims to the arsenal of public law protections\(^9\) for proprietary information and assets.

The exercise of that leverage should not cause a court much concern where the affected employee had enough bargaining power to negotiate an individual employment contract. Such an employee probably has enough information about the industry and enough prior experience to predict with some accuracy the risks to his future career posed by a covenant not to compete and to appreciate in particular the employer’s ability to impose litigation expenses upon him should he attempt to leave for an activity arguably barred by the covenant. In addition, the contract employee can probably secure some sort of protections against downward changes in the terms and conditions of the employment, including protections against discretionary discharge. The employee may also be able to integrate the employment contract with the covenant so that the employer’s right to enforce the covenant is conditioned upon proof that it has fulfilled its obligations to the employee under the employment contract.

When an employee had access to that kind of information and enjoyed that kind of bargaining power, it is reasonable to assume that the employee recognized the risks associated with the employer’s ability to sue for breach and secured something of particular value to the employee in exchange for accepting those risks. A court should normally hold such an employee to the terms of the covenant, as fully as it would any other bargained-for undertaking, absent clear proof that enforcement would threaten a public interest (such as preventing collusive restraints on productive competition to supply goods and services).

Few employees at-will enjoy that kind of bargaining power. Most employees at-will have only the power at initial hire to take or reject the job, and that power depends on how good the market is for the employee’s skills. By definition, an employee at-will has not secured an employment contract for a term or that protects them from discretionary discharge. Few employers will promise to maintain any particular terms or conditions of employment, other than those mandated by public law, during the period of at-will employment, however long or short it may be. An employee at-will, unlike the contract employee, cannot condition the employer’s right to enforce the covenant on performance of any employment contract.

In fact, the contractual significance of the at-will employment in this context might strike a lay person as paradoxical. If an offer of this defeasible status is treated as legal consideration, it enables formation of a binding covenant contract. That covenant imposes a unilateral obligation upon the employee that persists after the employment terminates without imposing any concomitant obligation upon the employer. Thus, by offering an at-will employment, or in some states by merely refraining from exercising the power of discharge, or simply by providing some additional emolument, the employer can construct a legally sufficient consideration to make the employee’s assent to the covenant binding. The association of the covenant with an employment relationship, however tenuous, also preserves the covenant from facial challenge as a pure, and thus unenforceable, restraint on trade.\(^\text{10}\)

More importantly, in the context of an at-will employment this contractual construct allows the employer to claim that the employee’s unilateral obligation persists separately and independently of the employer’s conduct in the employment relationship. This gives the at-will employer an additional form of leverage over the at-will employee that should give courts and legislatures pause even if their only concern is economic efficiency. The additional leverage is this: an employer at-will is free (subject to public law limits) not

\(^{10}\) See Restatement (Second) of Contracts, supra note [3] at § 188(2)(b) (defining a “promise by an employee … not to compete with his employer” as “ancillary” to a “valid transaction or relationship.”); see also id. §§ 186, 187 for the prohibition on restraints of trade that are not ancillary to such a relationship. Texas state courts have dealt with the ancillary requirement repeatedly. See supra note [6].
only to discharge an employee but also to alter the terms and conditions of employment for ongoing employees for better or worse. When business is bad or the job market is soft, some employers may reduce compensation, increase workload, or otherwise diminish the quality of the job. The at-will employee is free to quit, of course, but if the employer is armed with a covenant not to compete, the employee’s most productive alternative work may violate the covenant. And so, the combination gives the employer a bit more leverage than it already enjoys as an employer at-will; it gives the employer the ability to squeeze the employee for concessions that might otherwise inspire him to quit. The leverage may not be used or the use may not be invidious; but, on occasion, the leverage may be deliberately misused to punish a disfavored employee, or it may be used in good faith but inefficiently to stem employee flight from a faltering business when the public interest would be better served by letting the employees move to a more vibrant competitor. It seems to me unrealistic and unfair to presume that the average at-will employee anticipated or bargained for this particular risk when he assented to a covenant not to compete.\footnote{If one accepts contract law as always being an appropriate regulatory regime, then judicial regulation designed to improve the caliber of the initial bargaining process might help employees better guard their future interests by giving them information about the covenant’s terms before they begin to work. See Rachel Arnow-Richman, Cubewrap Contracts: The Rise of Delayed Term, Standard Form Employment Agreements, 49 Ariz. L. Rev. 637 (2007) (hereinafter “Arnow-Richman/Delayed Term”) (arguing that employee noncompete and pre-dispute mandatory arbitration agreements should not be enforceable if not disclosed well in advance of the start of an employment.) In light of Professor Arnow-Richman’s work, it is interesting that Oregon recently amended its statute to require, among other things, that employees receive notice that a covenant will be required at least two weeks before the first day of employment. Or. Rev. Stat. § 653.295 (2007, eff. 1/1/08). Improving the initial bargain process might enable more employees to opt for different employments, if they have the choice, and so put pressure on an employer to reduce post-employment restraints to the minimum necessary to protect legitimate interests. Improving the front end of the covenant bargain process, however, does not preclude the at-will employer from exercising its leverage later unless the employee can succeed in negotiating restraints on the employer’s at-will prerogatives. See Rachel Arnow-Richman, Cubewrap Contracts and Worker Mobility, The Dilution of Employee Bargaining Power Via Standard Form Noncompetes, 2006 Mich. St. L. Rev. 963, 981-4 (2001) (hereinafter “Arnow-Richman/Dilution”) (arguing, in part, that the widespread use of standard form noncompetes creates an \textit{in terrorem} effect by inculcating acceptance of the employer’s definition of its rights that then deters employees from quitting and testing the bounds of the covenant).}

Nor is this leverage merely a theoretical problem. The cases discussed below involve disputes over the enforceability of a covenant that arose after a period of conflict between the employer and employee over issues like increases in workload or decreases in compensation. It seems likely that we will soon see more of these. As I write in the

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summer of 2009, as firms try to cope with the “great recession” through layoffs, furloughs and wage and benefit cuts and as the official unemployment rate in the United States threatens to pass 9.5 percent, we can anticipate that some firms will exercise this leverage in an effort to avoid their own “creative destruction.” As a result, we may see increased litigation between employers and employees at-will over the enforceability of covenants not to compete in this kind of scenario.

Unfortunately, given the absence of much cogent judicial analysis of this leverage issue and given the prevalence of precedents about whether or not employment at-will constitutes consideration for a covenant, employee counsel may resort in desperation to arguments based on a technical failure of consideration in an effort to derail the employer’s contract claim as quickly and cheaply as possible. But courts ought not to follow them down that path if they have any interest in making the law more understandable, predictable and fairer to both sides of these deals.

In my view, almost every employee assent to a covenant actually reflects a bargained-for exchange – albeit often an adhesive and hard one for some employees at-will. In the case reports, there are no gratuitous covenants and precious few that seem any more involuntary than most adhesion contracts. Nevertheless, because of the paucity of authorities that deal with the leverage issue overtly, I think employee counsel resort to defenses based on failures of legal consideration at the outset of the relationship when the dispute may be due to problems with the substantive consideration, both economic and dignitary, during the employment relationship.

Appellate courts, however, have the power to improve the arguments – and ultimately improve employer’s drafting, negotiation, and use of covenants -- by expressly recognizing that the presence or absence of formal consideration will not shed any light on whether the employer has a legitimate interest in preventing the employee’s activity. Nor will judicial decisions that relieve employees from covenants and overreaching employers on the grounds of a failure of consideration produce precedents that will ultimately mitigate undesirable and inefficient practices.
I wrote this article in an effort to improve the rhetoric of counsel’s arguments and appellate opinions in this area of law by organizing some legal and economic rationales for according covenants different levels of contractual significance depending upon the bargaining capacity of the employee. Arguments about whether at-will employment does or does not provide legally sufficient consideration seem to me factually and psychologically implausible, and intellectually and doctrinally incoherent. At best, they inject confusion and unpredictability into otherwise fairly well-settled definitions of consideration and of employment at-will and bring discredit to the courts. At worst, by focusing on technicalities of contract formation, they perpetuate an ideology in which diverse and complicated relationships are all categorized as comparable bargained-for exchanges entitled to the same degree of judicial enforcement under contract law.

Lurking under all of this confusion, inconsistency, and incoherence is a fundamental substantive inequity – that an employer can insist upon a serious concession of future liberty while giving up none of its own. Freedom of contract provides the template for avoiding mutuality of obligation.12

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Part 2

In this part I summarize the relevant law and widely-accepted academic analyses to show that, even from a traditional standpoint, contract law can be, but is not necessarily, the appropriate regulatory frame within which to distinguish appropriate restraints on employees’ post-employment activities from those that are not.

At the heart of my thesis -- that for purpose of covenant enforcement the significance of an employee’s apparent assent to the covenant’s restraints should vary from negligible to strict depending upon the employee’s bargaining capacity -- lies the simple idea that the legal system should enforce private commercial agreements according to their terms when we have reason to think that the parties can take care of themselves in a negotiation and that in taking care of themselves they will promote, or at least not impair, the public interest in individual and collective welfare. The more reason we have to doubt that either proposition is true, the more the legal system should condition enforcement upon compliance with regulation designed to protect the public’s interest even if, as a matter of economic theory, corrective justice, or indifference, we might be inclined to leave the parties to endure any purely personal consequences of poor choices.

I think that in this context and given contemporary social mores, the fundamental public interest is in maximizing personal liberty. So long as we live in a market-based economy something like we have now in the United States, some prerequisite for personal liberty appears to depend on exchange transactions: on being able to sell one’s services to an employer and on having access to goods and services at competitive prices. That boils down to saying that employers need enough legal protection against uncompensated transfers of the values of their investments in employee hiring and training, customer service, research and development of products, to give them incentives to make those kinds of socially desirable investments. To the extent that employees, or non-employee workers, as a result of those investments, have particular access to proprietary

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information and assets and may be peculiarly able to transfer their value to themselves or another competitor without compensation to the employer, it is in the public interest to give that employer the ability to deter or to be compensated for such transfers. The trick is to get the level of deterrence or compensation just right. In theory, too much of either impinges unnecessarily on the employee’s liberty and threatens the public’s interest in productive competition by locking up talent and resources. Too little depresses employment rates and compensation.\textsuperscript{14}

Contract law may be an appropriate regulatory regime for getting the level of deterrence and compensation about right when the employee and employer have reasonably balanced bargaining capacity. And personal consent to a restraint may be essential when the employer’s legitimate interests are difficult to specify in advance or are difficult to isolate from the employee’s personal skills. When one party lacks access to relevant information or practical ability to bargain effectively, however, formal indicia of bargaining – like an exchange of a standardized covenant for an at-will employment – give little assurance that the resulting restraints on the employee serve the public interest, much less the employee’s. Our common law legal traditions in this area arguably anticipated what we would now call market failure in situations like this by subjecting private covenants not to compete to substantial judicial supervision. That supervision is, effectively neutered if courts substitute for evaluation of the substance of the covenant a rigorous insistence only upon the indicia of a formative bargain on the facile assumption that transactions that adopt the form of a bargain are likely to be efficient.

Covenants not to compete have long been subject to substantial regulation. In early English common law, employee covenants not to compete were characterized as restraints of trade and were disfavored.\textsuperscript{15} By 1981 in the United States, the Restatement


\textsuperscript{15} See, e.g., Harlan M. Blake, \textit{Employee Agreements Not to Compete}, 73 HARV. L. REV. 625, 632 – 636 (1960) (hereinafter “Blake”) (observing that the early English courts’ refusal to enforce restraints on

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(Second) of Contracts reflected the view of the American Law Institute that the common law had evolved to a more permissive regulatory regime: employee covenants not to compete might be enforced provided their terms were consistent with a three-pronged rule of reason.\textsuperscript{16}

Most states enforce employee covenants not to compete although the details vary considerably. Nineteen states have enacted relevant statutes with significant differences in substance,\textsuperscript{17} including two that make employee covenants not to compete


\textsuperscript{16} The \textit{Restatement (Second) of Contracts}, provides, in part:

\textit{§ 188. Ancillary Restraints On Competition}

\textit{(1) A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade if}

\textit{(a) the restraint is greater than is needed to protect the promisee's legitimate interest, or}

\textit{(b) the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public.}

\textit{(2) Promises imposing restraints that are ancillary to a valid transaction or relationship include the following:}

\textit{(a) a promise by the seller of a business not to compete with the buyer in such a way as to injure the value of the business sold;}

\textit{(b) a promise by an employee or other agent not to compete with his employer or other principal;}

\textit{(c) a promise by a partner not to compete with the partnership.}

\textit{Restatement (Second) of Contracts § 188 (1981); see also id. §§ 186, 187. Compare Restatement (Third) of Unfair Competition §§ 38 – 45 (1995); Restatement (Third) of Agency § 8.04 (2006); Restatement of Torts § 757 (1934); Restatement of Contracts §§ 515, 516 (1932).}

\textsuperscript{17} Nineteen states have statutes that regulate various kinds of restraints on post-employment competition. See ALA. CODE § 8-1-1 (LexisNexis 2002); CAL. BUS. & PROF. CODE § 16600 (West 2008); COLO. REV. STAT. ANN. §§ 8-2-113(2) – (3) (West 2003); FLA. STAT. ANN. § 542.335 (West 2002 & Supp. 2007); GA. “Should I Stay or Should I Go?” Law Review Submission draft August 6, 2009
unenforceable.\textsuperscript{18} The remaining states that regulate covenants by common law have developed in different ways,\textsuperscript{19} due no doubt to variations in state histories and economies.

\begin{tabular}{l}
CODE ANN. § 13-8 §-2.1 (1982 & Supp. 2008); HAW. REV. STAT. ANN. § 480-4(c)(4) (LexisNexis 2009); WEST’S LA. REV. STAT. ANN. § 23.921 (1998 & Supp. 2009); MICH. COMP. LAWS ANN. § 445.772 (West 2002); MONT. CODE ANN. § 28-2-703 (2007); NEV. REV. STAT. § 613.200 (2007); N.C. GEN. STAT. § 75-4 (2007); N.D. CENT. CODE §9-08-06 (2006); OKLA. STAT. ANN. tit. 15, §217 (West 1993 & Supp. 2009); OR. REV. STAT. ANN. §653.295 (West 2003 & Supp. 2009); S. D. CODIFIED LAWS § 53-9-11 (2004); TENN. CODE ANN. § 47-25-101 (2001); TEX. BUS. & COM. CODE §§ 15.50 – 52 (Vernon 2002); W. VA. CODE ANN. § 47-18-3(a) (LexisNexis 2006); WIS. STAT. ANN. § 103.465 (West 2002). Some of these states also have pertinent constitutional provisions. E.g., Ga. Const. art. III, § 6, para. 5 (c)(providing that “[t]he General Assembly shall not have the power to authorize any contract or agreement which may have the effect of or which is intended to have the effect of defeating or lessening competition, or encouraging a monopoly, which are hereby declared to be unlawful and void.”)

Those statutes that permit any restraints vary considerably with respect to the type, purpose, geographic scope, duration, and other formal requirements. See, e.g., ALA. CODE §8-1-1(b) (providing that “one who is employed as an agent, servant or employee may agree with his employer to refrain from carrying on or engaging in a similar business and from soliciting old customers of such employer within a specified county, city or part thereof so long as the … employer carries on a like business therein); COLO. REV. STAT. § 8-2-113(2) (limiting enforcement of covenants not to compete to those relating to purchase and sale of a business, to protection of trade secrets, to training expenses for an employee who has served less than two years, and to executive, management and professional level personnel); FLA. STAT. ANN. § 542.335(1) (providing in part that “enforcement of contracts that restrict or prohibit competition during or after the term of restrictive covenants, so long as such contracts are reasonable in time, area, and line of business, is not prohibited” and setting out 11 conditions for enforcement, including a signed writing, §542.335(1)(a), and pleading and proof of a “legitimate business interest,” §542.335(b)); OR. REV. STAT. § 653.295 (1)(a) (providing in part that a covenant is invalid unless “(A) …employer inform the employee in a written employment offer received by the employee at least two weeks before the first day of the employee’s employment that a noncompetition agreement is required as a condition of employment; or (B) the noncompetition agreement is entered into upon a subsequent bona fide advancement of the employee by the employer”); TEX. BUS. & COM. CODE §15.50(a)(providing in part that a “covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.”).

\textsuperscript{18} CAL. BUS. & PROF. CODE §16600 (providing in part “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”) California does permit covenants not to compete upon sale or other disposal of a business entity, including partnerships and limited liability companies. §16601. California courts do not enforce covenants against employees under §16600; they do not recognize a “rule of reason” exception. Edwards v. Arthur Andersen LLP, 189 P.3d 285 (Cal. 2008). California courts may enforce narrowly-drawn confidentiality or non-disclosure agreements and customer non-solicitation agreements that are necessary to protect an employer’s trade secrets. See, e.g., Readylink Healthcare v. Cotton, 24 Cal. Rptr. 3d 720 (Cal. App. 2005); Thompson v. Impaxx, Inc., 7 Cal. Rptr. 3d 427 (Cal. App. 2003). See also BRIAN M. MALSBERGER, COVENANTS NOT TO COMPETE 997 – 1001 (6th ed. 2008); N.D. CENT. CODE §9-08-06 (providing in part “[e]very contract by which anyone is restrained from exercising a lawful profession, trade or business of any kind is to that extent void except [in the sale of goodwill of a business or dissolution of a partnership].) North Dakota courts, like California’s, have held that this statute prohibits enforcement of employee covenants not to compete. See, e.g., Werlinger v. Mutual Serv. Cas. Ins. Co., 496 N.W. 2d 26, 30 (N.D. 1993). Customer non-solicitation contracts are not enforceable either. Warner & Co. v. Solberg, 634 N.W.2d 65, 71 – 73. (N.D. 2001). See MALSBERGER, supra at 3713 – 3715.

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as well as the vagaries of litigation. Moreover, all the modern regulations governing covenants arose from multiple common law doctrinal traditions: contract, agency, tort and property. That doctrinal and rhetorical complexity permits courts to select from diverse rationales to suit a particular judgment and may contribute to an appearance of unpredictability.

19 Thirty-one states and the District of Columbia enforce employee covenants not to compete, non-disclosure and non-solicitation agreements to varying degrees under common law, although in some states the common law is subject to constitutional provisions governing restraints of trade. See, e.g., Wash. Const. art. 12, § 22 (providing that “[m]onopolies and trusts shall never be allowed in this state, and no incorporated company, copartnership, or association of persons in this state shall directly or indirectly combine or make any contract with any other incorporated company, foreign or domestic, through their stockholders, or the trustees or assignees of such stockholders, or with any copartnership or association of persons, or in any manner whatever for the purpose of fixing the price or limiting the production or regulating the transportation of any product or commodity. The legislature shall pass laws for the enforcement of this section by adequate penalties, and in case of incorporated companies, if necessary for that purpose, may declare a forfeiture of their franchises.”).

For a summary and comparison of the statutes and leading cases in all 50 states, see Malsberger, supra note [17] passim.


23 See Fisk, supra note [14] (providing a legal history of the development of the concept of ownership of an employee’s ideas).

24 See STONE, supra note [14] at 131 (observing that “[c]ovenants not to compete occupy a peculiar legal never-never land between contract and tort, in which party consent and externally imposed obligation are intimately but complexly intertwined.”). Conventionally, liability for tort is based on fault while liability for breach of contract is strict. For recent scholarly debates about the relevance of fault in contract law, see Symposium, Fault in American Contract Law, 107 Mich. L. Rev 1341 (2009).

If a stranger takes an employer’s proprietary information without permission, then that is likely to be tortious or even criminal, and the basis of the stranger’s liability is wrong-doing, or fault. An employee who engages in the same behavior is, presumably, also engaging in wrongdoing. It is the relationship between the employer and employee that provides the opportunity for the employer to convert this fault-based liability into the (relatively) strict liability of contract. This provides the employer with a prima facie case, even if there are or will be no damages, even if that is, the proprietary information has no value or no one else is able to use it to the employer’s competitive disadvantage. Of course, if the employer suffers no damages then being liable for tort or for breach of contract would not matter much – except for the litigation expenses associated with defending oneself. But contract-based liability does still have some advantages. A breach of contract can be pled without an allegation of damages, and the acts constituting breach are defined by the agreement (subject to the rule of reason or other state law regulation) and not by public law. A contract can be drafted to provide for a favorable forum in case of dispute and possibly for the recovery of the prevailing party’s expenses. In this context, too, there is the peculiar willingness of courts to issue injunctive relief on a claim for breach of contract if the employer can establish that the breach creates a likelihood of irreparable tortious damage to the employer’s proprietary interests.
Statutory language is not a reliable guide to state courts’ enforcement policies. For example, Montana’s statute is very similar to California’s and North Dakota’s in prohibiting any restraint on the exercise of a lawful profession, trade or business, except in the case of the sale of goodwill or the dissolution of a partnership, but Montana’s courts have permitted exceptions under a rule of reason.\textsuperscript{25}

Although the definitions vary, the black letter law in all the permissive jurisdictions conditions enforcement of a covenant upon the court’s determination that the employer has some legitimate business need for the covenant.\textsuperscript{26} In 1960, in his seminal article on

A tort-like, fault-like causation issue may lurk within the analysis of what a legitimate interest is for a covenant. Employees may have peculiar capacities to transfer the value of employer investments without having been the beneficiaries of much in the way of relevant employer investment. A clerical employee may have the ability to transfer a secret marketing plan to his next employer but only because he was hired and happened to have access to it – not because he learned to produce a marketing strategy from being employed. The transfer would probably be a breach of the common law duty of loyalty and might violate a trade secret statute. (A non-disclosure agreement may be necessary to secure trade secret protections.) A broader covenant not to compete would simply add a promissory obligation on top of a duty not to engage in this kind of unreasonable, tortious behavior. The employee’s ability to harm the employer competitively is not caused, except in a trivial way, by the employer’s investment in him. If the employee moves to a competitor, his capacity to transfer the marketing plan poses a risk to the former employer it is true, but a prohibition on working for the competitor seems disproportionate to the former employer’s investment in his employment, and the clerical employee can probably work for the competitor without necessarily drawing upon his knowledge of, much less disclosing, the marketing plan. Put another way, the employer does not need the ability to enforce a covenant not to compete in order to preserve its incentive to hire the clerical worker.

\textsuperscript{25} Mont. Code Ann. §28-2-703 (2007) (providing that “[a]ny contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than in [a sale of goodwill of business or dissolution of partnership] is to that extent void. See Mont. Code Ann. §§ 28-2-704, 28-2-705. Unlike California, however, Montana will enforce an employee covenant not to compete if it is restricted as to time or place, is supported by consideration, and is reasonable in affording “only a fair protection to the interests of the party in whose favor it is made.” See Access Organics, Inc. v. Hernandez, 175 P.3d 899, 903 (Mont. 2008) (recognizing a cause of action for breach of a covenant not to compete, but holding that the employer had failed to provide consideration); see also Mont. Mountain Prod. v. Curl, 112 P.3d 979, 982 (Mont. 2005) (refusing to enforce a post-employment restraint with a 250 mile radius because it precluded the employee from practicing her profession “in the vicinity of where she lives.”).

\textsuperscript{26} See, e.g., Norlund v. Faust, 675 N.E.2d 1142, 1154-55 (Ind. Ct. App. 1997), \textit{opinion clarified on denial of reh’g}, 678 N.E.2d 421 (Ind. Ct. App. 1997) (noting that “[t]he employer must have an interest which he is trying to legitimately protect. There must be some reason why it would be unfair to allow the employee to compete with the former employee. The employee should only be enjoined if he has gained some advantage at the employer’s expense which would not be available to the general public” and giving as examples covenants that protect trade secrets to which the employee had access or goodwill that the employee was hired to create); Lawrence & Allen, Inc. v. Cambridge House Res. Group, Inc., 685 N.E.2d

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employee covenants not to compete, Professor Harlan Blake identified the three major types of legitimate interests, which persist in the cases today: employee training, customer relations/good will, and confidential proprietary information, including trade secrets. The traditional formulation of the rule of reason also requires that the covenant be narrowly tailored to protect the interest and that the detriment to the employee not outweigh the benefits to the employer. In practice, the second and third elements of the rule of reason simply inform the contours of a legitimate business interest and do not provide separate criteria for decision.

434, 443 (Ill. Ct. App. 1997) (noting that “[g]enerally, there are two situations in which a legitimate business interest will exist: (1) where the customer relationships are near permanent and but for the employee’s association with the employer the employee would not have had contact with the customers; and (2) where the former employee acquired trade secrets or other confidential information through his employment and subsequently tried to use it for his own benefit.” [internal citation omitted].)

Supra note [14] at 11 – 20. But see Gillian Lester, Restrictive Covenants, Employee Training, and the Limits of Transaction – Cost Analysis, 76 Ind. L. J. 49, 54 - 71 (2001) (discussing courts’ reluctance to enforce restrictive covenants that restrict a former employee’s transfer of the value of “training” to himself or another and exploring the limits of “transaction cost analysis” for those types of covenants).

See, e.g., Lazer Inc. v. Kesselring, 823 N.Y.S.2d 834, 838 -39 (Sup. Ct. 2005) (holding that covenant did not protect a legitimate interest where it barred employee from recruiting another employee who did not possess confidential proprietary information or trade secrets), citing Am. Inst. of Chem. Eng’rs v. Reber-Friel Co., 682 F.2d 382, 387 (2d Cir. 1982); see also BDO Seidman v. Hirschberg, 72 N.E.2d 1220 (N.Y. 1990). See supra note [14] at 10: “Like rules of reason generally, this formulation is so general as to throw little light on specific detailed problems. Furthermore, it is artificial-even inaccurate-in its description of the deliberation which actually takes place. For example, the permissible limits of employer protection cannot be defined without simultaneous attention to the correlative interests of the employee; nor can such a balancing of employer and employee interests proceed without reference to the public interest in workable employer-employee relationships, on the one hand, and in individual economic freedom, on the other. Thus, some courts have reformulated the first branch of the test to state that a restraint is reasonable only if it is no greater than is required for the protection of the employer in some legitimate interest. [citation omitted]. With this formulation, they find greater freedom to engage in a balancing of all the factors which they consider relevant. However, having completed the analysis of the extent of a protectible interest, courts usually find the relevant considerations exhausted; the other branches of the RESTATEMENT formulation are seldom, as separate considerations, given much attention. This does not mean that the interests of the employee and the public are necessarily slighted, but only that “undue hardship” to the employee and “injury” to the public are measured against the urgency of the employer's claim to protection, rather than against some extrinsic standard. This is only to say that courts treat the problem as a normal exercise of judgment, while the RESTATEMENT formulation has a check-list conceptualism about it. In addition, although the “undue hardship” limitation might open the way for consideration of the personal circumstances of the restrained employee-his financial circumstances or other factors unrelated to the employment relationship-such considerations are not often treated in opinions. It seems reasonably clear that they should not be, except, perhaps, under most extraordinary circumstances.”
Practicing lawyers and academics often fault courts for unpredictability, observing among other points that judicial opinions in this area vary in the significance they assign to the legitimacy of the employer’s interest relative to the significance of the employee’s assent to the covenant. It is as if, in hard cases, a given court will swing unpredictably between judgments based primarily on tort analysis and contract analysis – that is, between finding that the employee is or is not bound by the covenant because her actions do or do not threaten an unreasonable invasion of the employer’s legitimate interests to finding that the employee is or is not bound based on some promissory undertaking at the time of the covenant’s formation. My four factor proposal might reduce unpredictability in that it would direct use of a tort analysis where the covenant was not negotiated and a contract analysis where it was.

The diversity of state regulation of covenants also contributes to unpredictability for multi-state employers and mobile employees. That diversity has encouraged some recent races to the courthouse as parties try to take advantage of differences in state laws.

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29 See Michael J. Garrison & John T. Wendt, The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach, 45 AM. BUS. L. J. 107 (2008) (hereinafter “Garrison & Wendt”) (suggesting that the concept of “inevitable disclosure” would be a fairer and more predictable basis for protecting employer trade secrets than enforcement of covenants not to compete); Rachel Arnow-Richman, Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Non-Compete Agreements, 80 OR. L. REV. 1163 (2001) (hereinafter “Arnow-Richman/Bargaining”) (arguing that the traditional substantive requirement that a non-compete agreement will be enforced only if it is necessary to protect an employer’s legitimate business interest produces inconsistent judgments because employers are not just interested in protecting property-like assets but are bargaining for the workers’ personal capacities and loyalty); Jordan Leibman & Richard Nathan, The Enforceability of Post-employment Noncompetition Agreements Formed After At-Will Employment Has Commenced – The ‘Afterthought’ Agreement, 60 S. CAL. L. REV. 1465, 1479, 1510, 1557-58, 1566-67 (1987) (hereinafter “Leibman & Nathan”) (arguing that employers may develop legitimate needs to restrain particular employees after some period of employment, that employees ought to have the power to bargain for compensation for such restraints, including the right to opt to retain at-will employment, and that failure of consideration ought not to be a basis for invalidating such agreements provided they are otherwise reasonable); Phillip J. Closius & Henry M. Schaffer, Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not to Compete – A Proposal for Reform, 57 S. CAL. L. REV. 531 (1984) (hereinafter “Closius and Schaffer”) (arguing that agency law, in particular the employee’s duty of loyalty, provides better criteria than contract law for enforcement of post-employment restraints).

30 For example, in 2005 Microsoft and Google battled over the services of Dr. Kai-Fu Lee. Lee had signed a covenant not to compete with Microsoft in 2000, allegedly in exchange for being hired into a new position as a vice-president. Dr. Lee was an expert in developing speech recognition software and had previously worked for Microsoft in China where he had significant experience and business, academic and governmental contacts. In 2005, Lee resigned and moved to Google to help the latter build a research center in China. Microsoft sued in Washington state court to enforce Lee’s covenant not to compete. Microsoft won a preliminary injunction, Microsoft Corp. v. Lee, No. 05-2-23561-6 SEA, 2005 WL 4982161 (Wash. “Should I Stay or Should I Go?”

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The case is interesting for my thesis first because it involves a fairly high-level employee with the ability to negotiate an employment contract and covenant, second because, even so, the federal court in Washington found some of the covenant’s restraints legitimate and others not, and third because the federal court did not allow its judgment on the merits to be derailed by an argument about consideration.

On the legal issues, the injunction was a only partial victory for Microsoft, enjoining Lee from working for Google on certain products and projects that might compete with Microsoft’s and enjoining him from soliciting Microsoft employees, but the court specifically refused to extend the injunction to preclude Lee from using his contacts and relationships with students and academicians in China to staff a Google research center, noting that the relationships were the result of “his work and teachings both before and during his employment at Microsoft, as well as his personal outreach efforts. These relationships are not ‘peculiar to Microsoft’ and are not the type of interests that Washington courts have typically included when enforcing covenants not to compete….Washington courts must exercise caution before entering an order that would construe as proprietary or peculiar to any U.W. multi national (sic) corporation relationships with foreign students, foreign universities or foreign public officials.” Microsoft Corp. v. Lee, No. 05-2-23561-6 SEA, 2005 WL 4982161 (Wash. Super. Sept. 15, 2005) (order granting preliminary injunction). The court’s comment indicates not only reluctance to include something as inchoate as Lee’s ability to influence people in the scope of the covenant but also some diffidence about exporting the (unpredictable) effects of any one state’s law beyond the national borders. The court issued the injunction despite noting that “[a] question remains for trial where independent consideration exists to support the [covenant].”

The two companies’ contest for Dr. Lee was widely covered in the press including the parties dueling characterizations of the Microsoft’s motives as being to protect proprietary information or to stem a tide of employees flooding to Google. See, e.g., Robert A. Guth, Microsoft Sues to Keep Aide from Google, WALL ST. J., July 20, 2005, available at http://online.wsj.com (noting that “Dr. Lee is the highest ranking executive to join a small but growing number of Microsoft employees to leave the Redmond, Wash., company, for Google. … The 43-year-old computer scientist is credited with establishing Microsoft’s research and development center in Beijing, which houses about 380 researchers. … In Dr. Lee, Google stands to gain an executive with first-hand knowledge of Microsoft’s strategies and technologies. Search technologies were a “primary focus” of Dr. Lee’s work at Microsoft, according to the suit.”); Kristi Heim and Kim Peterson, The Man in the Middle, SEATTLE TIMES, August 8, 2005, at C1. (commenting that “the real struggle may have less to do with Lee’s technical expertise and more to do with his ability to influence a generation of young technologists, especially in China. And this influence may also help explain why, even after seeing a string of top talent defect to Google recently, Microsoft chose Lee’s move as the one to challenge in court.”)

See also Advanced Bionics Corp. v. Medtronic, Inc., 29 Cal. 4th 697 (2002) (holding that California’s ban on covenants not to compete did not justify injunction barring employer from suing employee in Minnesota to block employee from working for California competitor); Medtronic, Inc. v. Advanced Bionics Corp. 630 N.W.2d 438 (Minn. App. 2001) (holding that employer’s bad faith attempt to remove case did not amount to unclean hands that would preclude enforcement of covenant not to compete); but see Palmer & Cay, Inc. v. Marsh & McLennan Companies, Inc., 404 F.3d 1297, 1307 - 1310 (11th Cir. 2005) (holding, in diversity jurisdiction, that the scope of a declaratory judgment that a covenant was unenforceable under

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the proverbial laboratory of state regulation will produce a consensus, much less optimal regime, it has not yet succeeded.

In fact, the success of the technology industries in California’s Silicon Valley, despite or because of California’s ban on employee covenants not to compete, inspired scholarship that called into doubt the economic efficiency of employee covenants not to compete at least in some industries.\(^{31}\) I do not pursue that topic here except for the obvious inference that the fact that a state can develop an economy the size of California’s without enforcing employee covenants seems to be pretty good evidence that employers can protect their investments through other devices, whether those are public laws or narrower contracts, such as non-disclosure and non-solicitation agreements.

The balance of this Part is organized around two basic questions: first, what are the characteristics of a legitimate business need to prevent a former employee from competing, and second, what particular merit do contract doctrines, especially in contrast to public statute law and tort, have for protecting those interests?

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With respect to the first issue, a basic economic model provides one way to distinguish a legitimate business need from an illegitimate suppression of competition. In this model, a covenant not to compete creates a temporary restraint over certain of the employee’s activities after the employment is over, and that restraint is proper if it is necessary to promote desirable investments. In theory, if an employer would not hire an employee to do a job at all, or would not provide access to proprietary information or training to enable the employee to do the job more efficiently, but for the power to limit the employee’s ability to transfer the value of the information or training to herself or another without compensation to the employer, then the employer should have some legal device to deter injury to the value of these socially desirable investments and to compensate it if they are damaged. In this theory, a legal restraint on the employee’s capacity to make uncompensated transfers of the employer’s investments is efficient and fair. Without it, the employer will either not hire the employee, or will not provide access to information, or will lower wages across categories of employees to compensate for the risk of invidious competition by a few. So, this basic economic model suggests that employee covenants not to compete should be enforced to the extent – but only to that extent – that

32 For the seminal literature on the economic of covenants not to compete, see GARY S. BECKER, HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS 3 - 59 (2d ed. 1975) (hereinafter “Becker”); Oliver E. Williamson, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING (1985) (hereinafter “Williamson/Economic Institutions”); Oliver E. Williamson, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 176 – 207 (New York: The Free Press, 1975); Paul H. Rubin & Peter Shedd, Human Capital and Covenants Not to Compete, 10 J. LEG. STUD. 93 (1981). Very simplified, Becker’s influential book on Human Capital, advanced the idea that education and training develop “capital” in human beings that can be analogized to financial capital. In part, Becker argued that workers "pay" for general training through lower wages and that firms "pay" for firm specific training. His argument was that firms will not invest in general training because the employee can market that training to any other firm. Non-competition agreements that are conditions for employment are another mechanism by which an employee "pays" for training, whether general or specific. Becker is convinced that skills, unlike intellectual property, "are automatically vested, for a skill cannot be used without permission of the person possessing it. The property right of the worker in his skills is the source of his incentive to invest in training by accepting a reduced wage during the training period and explains why an analogy with unowned innovations is misleading” at least in modern technology - based businesses. Becker, id. at 40. If Becker’s theory is valid, then one implication is that, if skills are vested personal liberty interests, then they may only be restrained, if at all, with the owner’s consent, presumably by contract. Interestingly, however, in the dispute between Microsoft and Kai-Fu Lee, the federal court was reluctant to apply the covenant, negotiated as it was and well-paid as Dr. Lee presumably was, to prevent him from using his personal connections and reputation on Google’s behalf in China. See supra note [29].
enforcement is necessary to ensure that employers do not forego hiring or training employees or giving them access to information that makes their work most productive.\textsuperscript{33}

Difficulties remain, of course. Even if one accepts the basic economic model, the optimal degree of restraint may be very hard to determine. It will vary among industries according to the size and longevity of markets for particular products and services, the significance of investments in research and development and in customer relations, and individual employees’ capacity and opportunities to pose a competitive threat.\textsuperscript{34}

The character of the employer’s interests and the employee’s capacity to threaten them also influence the way the formative bargain and a later breach may be characterized. If the employer’s principal goal is to protect its investment in training or in proprietary information, the covenant can be characterized as an unremarkable commercial exchange – the employee gains compensation and access to an employer’s training or to proprietary information in exchange for a promise not to divert those assets to the employer’s disadvantage. For purposes of contract doctrine, there would seem to be no formal need for a separate and additional consideration. Although the employee’s breach of the covenant may be classified as a broken promise, the injury to the employer is less like the loss of a promised performance than the kind of injury to extant interests that we associate with tortious or criminal invasions of property rights. The breaching employee

\textsuperscript{33} See \textit{supra} note [31 (on seminal economic literature)]. Students of intellectual property rules will recognize the balancing calculus here. Ideally, if not in practice, the temporary monopoly afforded by copyright or patent law should be just enough to ensure that the author or inventor has an incentive to create or invent but not so much that the public is deprived of access to the work or invention, or to derivatives of it, longer than necessary to provide the author or inventor a reasonable return on his investment. \textit{See, e.g., Eldred v. Ashcroft}, 537 U.S. 186, 243 – 258 (2003) (Breyer, J. dissenting) (arguing that Congress’ addition of 20 years to the copyright term is irrational and unconstitutional because it adds minimal incentive for the individual author to create works but increases the costs to those who would access the works.) Although grounded more in contract and less in property concepts, a covenant not to compete has some resemblance an intellectual property right. It gives the employer a temporary negative monopoly over a category of services the employee might perform and, similarly at least from the perspective of economic efficiency, that monopoly should be neither longer nor broader than necessary to ensure that the employer is willing to make the hire, invest in R&D, or serve the customers.

\textsuperscript{34} See generally, \textit{Symposium}, \textit{supra} note [30](discussing empirical findings about effect of covenants – or their absence -- in technology industries); see also Bishara, \textit{supra} note [30](distinguishing between the efficiency of covenants in technology and covenants in service employments).
is like a house guest who makes off with the silverware. The behavior would be wrongful regardless of whether the guest had promised not to steal.  

In an alternative frame, where the employer is principally interested in protecting itself from the employee’s deployment of personal skills, a covenant not to compete can be characterized as a servitude in which the employee assents, more or less willingly, to some restraints on her liberty in exchange for a job. In this frame the employer secures the right to preserve the value of an employee’s labor for which it has paid against the employee’s ongoing personal capacity to divert that value. The employee is more like a shopkeeper who, when selling her business, including goodwill, must covenant not to set up the same business nearby lest she divert the customers. In this frame the adequacy, rather than the legal sufficiency, of the consideration may seem more important because the employee is giving something up rather than getting something, like training. Therefore, the more informed the individual’s agreement and the more obvious it is that the individual has been paid well for her services and the post-employment restraint, the more reasonable that restraint may seem.

In practice, of course, the employer’s interests may straddle these categories, and we might suspect where the law provides an opening for litigating about consideration, employers will have incentives to describe the covenant as an exchange of employer assets for the covenant while the employees will describe the covenant as a restraint on deployment of personal skills. The employer’s strategy emphasizes the bargain inherent in the employment and thus minimizes the need for an additional consideration, whether merely technical or substantial. The employee’s strategy makes the deal look more one-sided and increases the odds that a court will find a failure of technical consideration or an inadequate business interest.

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35 Arguably, if the silverware has no value to its owner, the theft is meaningless, except for the breach of promise and possible dignitary insult to the promisee. See, e.g., Ossur Holdings, Inc., v. Bellacure, Inc., 2005 WL 3434440, *6 (W.D. WA. 2005) (denying former employer’s motion for preliminary injunction on ground that it had failed to establish likelihood of irreparable harm from breach of non-competition, confidentiality and non-solicitation agreements because plaintiff had failed to persuade court that it had trade secrets or confidential information to protect).
If the basic economic model just described treats a covenant mainly as a device to protect desirable employer investments, another related analysis has a more psychological or behavioral tilt. It treats a covenant as a device to construct a cooperative relationship and to deter opportunistic exits from the relationship, as well as a device to protect relatively identifiable investments.\textsuperscript{36} The outer limit on any device that controls the individual’s

\textsuperscript{36}See \textsc{Williamson/\textsc{Economic Institutions}, supra} note [31]. Simplified, Williamson’s central point of relevance here is that firms develop to do things that market transactions cannot do efficiently. "[T]he joining of bounded rationality [arising from complexity and information impactedness] with uncertainty makes contractual completeness expensive (if not infeasible) to attain, while incomplete contracts expose market-mediated exchange to the hazards of profit haggling if small numbers bargaining conditions obtain. Because it is able to suppress or avoid opportunistic profit haggling, internal organization is able to tolerate contractual incompleteness." \textit{Id.} at 124. Williamson hypothesizes that the employment relationship essentially substitutes for the necessity to engage in repeated incomplete agreements, i.e. on-going contract negotiations.

Williamson usefully explains the difference between an initial hire and the continuing employee. In an initial hire, one can posit that large-scale market transactions probably tend toward an efficient allocation of resources, but once an employee is on the job, the employee develops certain idiosyncratic understandings of the work and the other "team" members that give the employee special value and thus take the continued employment relationship out of the large-scale market into the small-scale market where numerous transactions cannot be relied upon to achieve an efficient result. In such a situation, the employment relationship substitutes for the inability to draft a contract that can adequately regulate complex and unknown contingencies. "What one wants to devise is a contractual relationship that promises fair (competitive) returns, promotes adaptive efficiency, and is relatively satisfying in terms of the involvement experience." \textit{Id.} at 99. In the employment relationship, the employee relinquishes claims over individual profit streams in return for steady compensation, promotion within the firm hierarchy and rewards for team work, such as stock options as means to reap a portion of increases in the overall company's share value. \textit{Id.} at 104. Williamson contrasts such incentives with bonus payments that introduce transaction specific elements into the contract and jeopardize the integrity of the employment relationship. \textit{Id.} at 129-30. \textit{See also} Posner & Triantis \textit{supra} note 13.

\textit{Compare} \textsc{Stone. supra} note 14 at 56 - 60 (criticizing both Becker and Williamson’s theories for failing to recognize that their theories overlook the expectations created by mid-twentieth century labor practices in which many employees understood their employers to have made implicit promises of long-term employment that encouraged loyalty and minimized the problems of knowledge-sharing) I take Stone’s point that the rationales have outlived the practices so that in both theory and practice restrictions on employees’ competition remain valid while job security has largely vanished. \textit{See also} Stewart Macauley, \textsc{Relational Contracts Floating on a Sea of Custom? Thoughts about the ideas of Ian Macneil and Lisa Bernstein}, 94 Nw. U. L. Rev. 775-804 (2000) (symposium issue devoted to relational contract theory.) To simplify one aspect of relational contract theory, one can say that contracts actually form along a continuum from "as if discrete" transactions to complex evolving relationships and that a focus upon formal contracts and their terms may not reveal the parties actual expectations or practices. The relevance of this theory here is that judicial efforts to unpack the content of the content of an employment relationship and a covenant not to compete by reference to the terms set at initial hire may not reveal the the parties' understandings, expectations, commitments and informal or extra-legal sanctions for good or bad behavior by the time of a later dispute. Nor would the presence of absence of consideration at a given moment, such as initial hire, have much probative significance for defining the contours of a contractual relationship that evolved through a series of implicit or explicit exchanges over the life of the contract. See Stewart Macauley, \textsc{An Empirical View of Contract}, 1985 Wis. L. Rev. 465, for a seminal article on the uses of empirical data to illuminate the difference between legal conceptions of contract and actual practices.
liberty, of course, is the Thirteenth Amendment; an employer cannot mandate cooperation or force an employee to continue working against her will. And at some outer limit, the employer cannot prevent the employee from earning a living. The more the employer’s interests coincide with the employee’s personal characteristics – intelligence, knowledge, experience, skills – the more any restraint on their post-employment risks begins to look like a culturally, if not legally, impermissible sort of servitude.

Uncertainty about how courts may differentiate between an employee’s personal attributes whose knowledge and skills may not be restrained at all from those that are to be deemed the product of employer investment and may be restrained is another source of unpredictability. With respect to that issue, it is interesting that a federal district enjoined a former Microsoft executive from working for Google on certain specific projects in China but refused to bar him making use of his personal contracts and reputation in China on Google’s behalf. One might have thought that the more negotiated the restraint’s terms, the more experienced and relatively well-compensated the employee, the higher the tolerance might be for enforcing restraints on the employee’s deployment of personal attributes or skills. Even in this case, however, the court found that interpreting the covenant to extend to such activities would be unreasonable.

37 U.S. Const. Amend. XIII (prohibiting slavery and indentured servitude); see also U.S. Const. Amend. V (prohibiting deprivation of liberty without due process of law).

38 See discussion of Microsoft Corp. v. Lee, supra note [29]. The trial judge deserves credit for having deferred to trial (which never took place) Dr. Lee’s allegation that the covenant lacked legally sufficient consideration. The court, appropriately in my view, focused on the legitimacy of Microsoft’s interests first. The court did not mention whether Dr. Lee had had some bargaining capacity to negotiate the terms of the covenant when he was hired as a vice-president. We can suspect that he did and that he understood to some extent the risks he took in agreeing to it. Therefore, this decision seems to me more likely to be “right” than not.

39 See Bishara, supra note [30], for a partially related argument. Prof. Bishara suggests that covenant enforcement should be stronger where employees provide customer services and weaker where they work to develop innovative technologies. To the extent that the former group’s capacity to compete is a function of something plainly separable from themselves – such as lists and data about customers – while the latter group’s capacity to compete is based on intelligence, experience and internalized information that may be “acquired” but is hard to differentiate from personal attributes or skills, then our recommendations might be consistent. But I think Bishara’s emphasis on the type of work oversimplifies matters. So, for example, a skilled salesperson may be valuable to an employee not because he is using proprietary information to make customer contacts but because she has some personal traits – as yet not defined -- that make her very

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In an easier scenario, the employer will have already invested in product research and development, marketing strategies, and customer development before the hire. These investments will have generated intellectual property, trade secrets (including negative know-how) and good will. If the employer hires a new employee to do work that requires access to any of these intangible assets, the employer may properly wish to prevent the employee from diverting the value of those assets to herself or to another for competitive use. Of course, in these cases, an employer might rely on intellectual property and trade secret laws to protect most of these assets from uncompensated transfer, and it might use relatively narrow non-disclosure and non-solicitation covenants to protect specific information or customers from such transfers. On the other hand, it should be noted that the employer may be fully compensated for affording the employee access to proprietary information if the employee puts that access to good use in her work.

40 See discussion of Microsoft Corp. v. Lee, supra note [29]. The court’s holding on this aspect of the covenant is interesting in light of the Washington Supreme Court’s decision in Perry v. Moran, 748 P.2d 224 (Wash. 1989), modified on reconsideration, 766 P.2d 1096 (1980), which was of course binding. In Perry, the court had enforced a covenant according to its terms – which prevented an accountant, Judith Moran, from servicing any clients of the Perry accounting firm after termination and providing for liquidated damages if she did. Moran was already experienced in the profession before Perry hired her, 748 P.2d at 225. She left about a year later. Although she did not solicit any former clients directly, she did give notice of her own accounting business to other entities who then referred clients to her, some of whom were Perry’s former clients. Id. at 226. The court upheld the covenant’s five year restriction on servicing any clients, no matter how obtained. The dissent objected that the covenant was unreasonable in scope – because it prohibited servicing clients without whom Moran had had no personal contact – and because it was too long. 748 P.2d at 231- 234 (Utter, J., dissenting).

Could one have argued that the restraint in Perry simply prevented the deployment of the accountant’s personal skills, acquired elsewhere? I raise the question not to fault the judge in the Microsoft case whose reluctance to restrain Lee from networking with his contacts in China seems sound to me, but to suggest that perceptions of what covenant terms overly restrain an ex-employee’s deployment of skills may be highly contingent, and may be influenced by contemporary judicial attitudes about the needs of particular professions and industries, and perhaps attitudes toward class, education, gender and other formally irrelevant matters. Cf. Bishara, supra note 30 (arguing, on instrumental grounds, for stronger enforcement of covenants with service workers and weaker for knowledge workers). It may also be that Dr. Lee, with support from Google, was very effectively represented by legal counsel.
and it is also possible that the access to the information that originally provided the consideration for the covenant not to compete is long since irrelevant, or has been replaced by access to other and possibly different information by the time a dispute arises. It is hard to understand why, in such a case, the status of the original information as consideration would be relevant to the legitimacy of the employer’s later attempt to enforce the covenant.

In more complicated cases, the employer may wish to protect not only assets generated before the employment but to ensure that it is able to extract value from assets generated during the employment by the employee alone or in collaboration with other workers. To the extent that those assets are reasonably identifiable as intellectual property, trade secrets and good will, then pre-invention assignment contracts and default ownership rules will generally mean that the ownership of the fruits of the employee’s labors, alone or with others, will vest initially in the employer.41 The covenant not to compete will operate much as it would with respect to assets developed prior to the employee’s hiring. It would deter the employee from transferring them or their value to another without compensation once the employment ends. An employer may be more inclined to use a relatively broad covenant not to compete, rather than a narrower non-disclosure or non-solicitation agreement, in this situation because of uncertainty about what kind of assets might develop during the employment. The more individualized negotiation with the employee, the more a court might assume that the employee as well as the employer understood the uncertainties and risks and was paid to accept them.

The most difficult cases involve control over the use of knowledge and skills that the employee may have brought with her to the job or that she develops in consequence of working at a job, especially over a long period of time.42 To the extent that the

41 See, e.g., Rochelle Cooper Dreyfuss, Collaborative Research: Conflicts on Authorship, Ownership and Accountability, 53 Vand. L. Rev. 1161, 1172 – 82 (May 2000) (analyzing extent to which the U.S. Copyright and Patent Acts succeed in unifying, fairly compensating, and deterring disputes over proprietary information and intellectual property. Dreyfuss notes that private ordering may not always protect the public interest, much less the weaker negotiator.).

knowledge and skills can be traced to employer-provided training, a reasonable argument can be made that the employer should be able to recoup at least the cost of the training and retain control over any proprietary information imparted if the employee leaves the employment before the employer reaps a reasonable return from the investment in training. But outcomes in disputes over training will be difficult to predict because the value (at the time of training) of an investment in training may be higher or lower when the trainee departs, depending on the trainee’s capacity to internalize and deploy the training in an available market. One court may see a protectible interest in training where another, even in the same state, does not. It may be very difficult to identify the “investment” source of an employee’s knowledge and skills. A further difficulty concerns whether general knowledge or skills – such as familiarity with industry culture and personal relationships, generic procedures, problem-solving, or effective sales techniques – can be isolated from the proprietary information to which they may relate or with which they may be inextricably entwined. In these most difficult cases, it has been suggested that the “inevitable disclosure” doctrine might be a more predictable basis for protecting an employer’s assets than a covenant not to compete.

“grossly unfair,” id. at 750, where the employee had signed one covenant near the onset of his employment and had then been promoted through various jobs, and noting that “the non-disclosure provisions are written so broadly as to cover everything Mr. McGough might have learned while working at Nalco, [sic] if he were to strictly abide by its terms, he would be unable to ever work in a similar field again.” Id. at 756. See also Microsoft Corp. v. Lee, supra note 29 (refusing to enforce a covenant to the extent it precluded use of personal contacts and reputation developed over years of work, some preceding the relevant employment).


Compare KGB, Inc. v. Herbert, 2008 WL 2076207 (Wash. Super. Trial Order) (holding that a covenant not to compete was enforceable but reducing the term from three years to one against a drain and rooter service employee, who appeared to have had a maximum of two-weeks training and about five months of employment in standard techniques, and who did not have repeated customer contact) with Copier Specialists, Inc. v. Gillen, 887 P.2d 919 (Wash. Ct. App. 1995) (holding that a photocopy repair business had no protectible business interest in enforcing a covenant not to compete against a short term photocopy repair employee who had gained nothing more than basic skills from the training and employment.)

See Pepsico v. Redmond, 54 F.3d1262 (7th Cir. 1995) (holding that an executive would inevitably disclose trade secrets if he were to take a position with the employer’s competitor); see also Garrison & Wendt, supra note 28 (discussing among other cases the litigation between Microsoft, Kai-Fu Lee and Google, see supra note 29, the authors argue that the rule of reason requirement for covenants’ restraints cannot be made to differentiate reliably between the employer’s legitimate interest and the employee’s in these kinds of cases and that the effort to manage the interests by contract should give way to the “inevitable disclosure” doctrine, which enables a court to assess at the time of a dispute whether the
The second question concerns what particular merit private contractual ordering may have for protecting business interests that may be legitimate. That is, what might contract formation rules do to increase a court’s confidence that the interest arises from a desirable investment, that is, that giving the employer a temporary negative monopoly on the ex-employee’s services is necessary to protect the value of that investment, and that the effect on the ex-employee’s liberty is not oppressive? Does contract doctrine help the parties draft and perform agreements and does it help a court make a fair, and predictable, allocation of rights to the employee’s post-employment activities?

If we accept that the economic efficiency rationales are paramount, the first question may be whether compliance with formation rules provides any assurance that a given employer is not unduly suppressing competition that would be in the public interest. A court might assume, in an effort to short-cut expensive fact-finding, that prospective employees, who enjoy sufficient bargaining power to negotiate individual employment contracts for a term or with protections like for-cause-only discharge and severance benefits also have sufficient experience in an industry to perceive the risks to their future careers and earning power of a covenant not to compete. In such cases, a court might assume that, in general, these prospective employees’ self-interest will roughly accord with the public interest in the maximum amount of efficient competition.

employee will inevitably draw upon a former employer’s proprietary information in a new employment.) I do not disagree that the tort-like evaluations of “inevitable disclosure” rationales might be more predictable – at least for a while, until lawyers found cracks in the doctrine. I think, however, that the inevitable disclosure doctrine should only increase concern about due process in depriving an individual of the use of “vested” personal skills. See Becker, supra note __. My recommendation, however, would have the virtue of allowing employers and employees to bargain over and enforce restraints in “hard cases” if they could demonstrate substantial, evenly matched negotiation and adequate compensation to the employee. The proposal avoids leaving all conflicts to a court’s ex post discretion while subjecting private ordering to the risk of some judicial substantive intervention absent evidence of a negotiated deal between matched parties with substantively equivalent bargaining power and ability to anticipate and manage risks.

46 See, e.g., Harvey J. Goldschmid, Antitrust’s Neglected Stepchild: A Proposal for Dealing with Restrictive Covenants Under Federal Law, 73 Colum. L. Rev. 1193, 1204 – 07 (1973) (arguing for some federal regulation under antitrust laws to prevent certain employers from gaining too much control over competition in their industry.)

47 I recognize that this analysis is circular in the sense that it depends on relatively powerful economic actors’ understanding of their self-interest and then adopts the evidence of their self-interest as evidence of efficiency. That legal or economic rationales may simply provide elegant rationalizations for social
disputes over covenants made by these kinds of employees, a court might be justified in assuming, absent convincing evidence to the contrary, that the covenant protected a legitimate business interest – and not too much.

On the other hand, where at-will employees have assented to a standard-form covenant not to compete as a condition for hire or, in some cases, for retaining the job, courts cannot assume that their self-interest will adequately protect the public’s. Some may not even be aware that the covenant is a condition until they arrive for the first day of work, making it unlikely that they considered the terms or shopped around for a job with fewer restrictions attached. Novices in an industry may lack sufficient information to judge the employer’s prospects or the risks to the employee’s own later career interests.

My point is not that courts should engage in paternalism. If an employee assents to a particular covenant under large market conditions – i.e. under conditions where she had a range of comparable employment opportunities, including some with less restrictive covenants – then a court might save itself time, and litigants’ expense, by assuming that the competition for labor would pressure firms to trim covenants’ restraints to efficient levels regardless of whether a particular individual appreciated the covenant’s import. So, for example, if a firm like Microsoft in Washington State, which tends to enforce employee covenants, competes for the same kind of workers with a firm like Google in California, which does not enforce employee covenants, a court might be justified in assuming that a worker who was equally able and willing to take a job with either should be bound if she assented to Microsoft’s covenant.

Absent evidence of large-market conditions or individualized negotiations with substantial substantive benefits to the employee, evidence of legally sufficient contract formation – assent to a written covenant in exchange for an at-will job – provides no grounds for assuming the restraints’ efficiency. This is true whether the formation takes

organizations that have more complicated roots and purposes than transaction cost analysis may reveal seems likely. Yet, if the rationales are not necessarily “true,” they are so widely believed in and out of courtrooms that it seems pragmatic to deal with them. 48 See Arnow-Richman/ Delayed Term, supra note 11.
place before hire or during an employment. The latter differs only in the sense that the employee is less likely to enjoy practical access to alternative, comparable employments.

As noted above, however, a covenant not to compete may also be a vehicle for establishing a collaborative ethos within a firm. Rather than allocating rights to a limited set of fairly well-defined resources, like customer contacts in exchange for a job, the covenant operates to protect the multiple participants’ mutual investments in developing some aspect of a commercial enterprise, whether it be a product, marketing plan, or customers, or all of them at once. The covenant sets a shared expectation that no one individual is entitled to hold up the others by threatening to depart with a key idea, process, customer, etc. If a participant later threatens to exit and compete, in theory the firm’s ability to obtain injunctive relief may prevent an opportunistic hold-up of the enterprise.\footnote{See Williamson/Economic Institutions, supra note 31 at 124.} This ability may be especially valuable if the enterprise is young and has not yet been able to convert inchoate know-how into a profitable product. In such cases damages such as lost profits from a new business or product line might be too speculative to be recoverable either under a claim for misappropriation of trade secrets or for breach of the covenant. In this situation, a court might look more tolerantly on the procedural advantages a covenant not to compete affords the employer. The employer has no viable claim for damages; its only leverage against an opportunistic employee may be the ability to impose upon the employee the costs and delays necessitated by defending a claim for breach of contract.

In this scenario -- which may better characterize the use of covenants in small or new ventures with relatively flat hierarchies -- the parties may have particular difficulty defining precisely the interests that must be protected (because they do not exist when the agreement is drafted) or about the future activities that might jeopardize them. The ability of the parties to continue working productively together may depend more on personal relationships than in larger organizations where people can move to different parts of the organization in case of conflict. If an individual wants to exit from the small
group, the motives and effects may be particularly challenging for a court to sort out. While a court might examine the relative bargaining positions of the parties, the caliber of the negotiations leading to the covenant, and the benefits flowing to an individual, it might be just as well to analyze this situation in tort terms – what reasonable people in like circumstances, given all the relevant information including the practical working relationships, would think was a fair resolution at the time of the dispute. To the extent that a party can provide evidence that they bargained on reasonably comparable terms not to have the court determine what behavior was reasonable but what they each promised, then a contract regime might be superior to tort or public law.

This flexibility is not available if a court perceives a covenant as a discrete transaction – say the provision of an at-will job, relatively short-term training, or access to a customer list, for example, in exchange for the covenant. Then, the covenant imposes a unilateral obligation on the employee once the employer provides the basic consideration, whether its value is significant or trivial.50 A court may have a hard time articulating a principled reason for granting or denying relief in a hard case – that is, a case where it is hard to differentiate the employer’s investments from the employee’s attributes, or a case where the caliber of the relationship has deteriorated to the point that continuation of the employment is obnoxious to one or both parties.

A doctrinal frame in which the employee’s unilateral obligation is formally isolated from the employment relationship creates particular stresses on conventional doctrines when the employer’s treatment of the employee seems unfair, but not illegal.51 In such cases, the court may have to strive to find a ground for denying an employer’s effort to enforce the covenant. One option may be to deny relief on the ground of unconscionability or equitable relief on the ground that the employer lacks clean hands. But, if an at-will employer’s conduct is otherwise legal, courts may be reluctant to seem to interfere with


51 See, e.g, Labriola, discussed infra at [Part 3]; see also Vanko, supra note [7] (discussing cases in which courts had to decide whether to enforce a covenant against an involuntarily discharged employee.)
its prerogatives. As I will discuss in the next section such a conundrum may inspire a court to find an alternative, if implausible, basis for denying the employer’s claim – such as invalidating the covenant altogether for failure of consideration.\textsuperscript{52}

If a covenant is conceptualized as a device for creating mutual behavioral norms, then it might be possible to import into the covenant some implied duties or some mutuality of obligation in the employer in addition to provision of the formal consideration. Continuation of collaborative work, participation at historic or rising levels of compensation and benefit schemes, might be implied into the terms of the covenant – even where the employee was at will and had no entitlement to any of those benefits for any particular duration under the at-will doctrine.\textsuperscript{53}

My proposal would encourage courts to adopt a realistic and relational approach to covenant enforcement, whether for damages or for injunctive relief, by treating facts concerning the employment relationship as relevant to the evaluation of the legitimacy of the employer’s business interest. The choice would not be bi-polar: contract or no

\textsuperscript{52} See Part 3, infra at pp. __; but see Iron Mountain Info. Mgmt. Inc. v. Taddeo, 455 F. Supp.2d 124 (E.D.N.Y. 2006) (applying Massachusetts law and holding that an employer must obtain agreement to a new restrictive covenant each time a job changes materially); Lycos Inc. v. Jackson, 18 Mass. L. Rptr 256 (Mass. Super. 2004) (denying enforcement of an older covenant where employer had promoted employee and had given employee an offer letter referencing the old covenant but employee had not agreed to a new covenant).

\textsuperscript{53} See infra at note [96] for a description of a failed effort to make just such an argument. See also Schneller v. Hayes, 28 P.2d 273 (Wash. 1934), (noting, in dicta, that the court would not order an equitable remedy, even if the covenant had been supported by legally sufficient consideration, where the employer had no corresponding obligation), discussed infra [at Part 3]

In general, however, failure to exchange substantively adequate consideration, much less to provide for mutuality of obligation, is not generally now regarded as a basis for avoiding a contract. See \textit{Restatement (Second) of Contracts}, supra note [3] at §§ 17, 71, 79 (defining consideration); \textsc{Morton J. Horwitz, The Transformation of American Law 1780 – 1860, 160, 210 (1969)} (describing a change in contract doctrine from concern with substantive fairness to bargain in the 19th Century: “And without the practice of enforcing pre-existing moral duties, judges and jurists could no longer ascribe any purpose to legal obligations that were superior to the expressed ‘will’ of the parties. As contract ideology thus emasculated all prior conceptions of substantive justice, equal bargaining power inevitably became established as the inarticulate major premise of all legal and economic analysis. The circle was completed: the law had come simply to ratify those forms of inequality that the market system produced.”); Ricks, \textit{supra} note [6]. However, equitable considerations may persist when a party seeks to enforce a contract by specific performance. The court has discretion to refuse granting the request if, among other things, “the exchange is grossly inadequate or the terms of the contract are otherwise unfair.” See \textit{Restatement (Second) of Contracts}, \textit{id.} at § 364 (1)(c).

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contract. Instead the employer’s management of the relationship would be relevant to the employee’s liability for breach of the covenant contract, and the employee’s performance of her duties in the employment as well as her post-employment activities would be relevant to the employer’s management of the employment relationship and enforcement of the covenant, if any. A wage reduction or a workload increase may be appropriate and necessary to a viable business. If so, then they might not abrogate the restraints on the employee’s activities, especially in those negotiated covenants where the employee may be fairly expected to understand the risks to her career of a business downturn and been compensated to some extent for assuming that risk. But if, for example, the demand for wage concessions indicates a business model that may be failing, then the court should be alert to the possibility that the employer is simply trying to stem employee flight through enforcement of a covenant. If the firm will limp along or fail, then it is unclear whether any public interest is fulfilled by enforcing the covenant against rank-and-file employees. The employee should be free to work productively and with better compensation and prospects elsewhere, particularly if the firm will not survive. The firm’s fate may be very difficult to predict, but unless there is evidence that the at-will employee has the capacity to deal it its death blow, destroying other at-will jobs in an enterprise that might otherwise survive, then it seems to me that the at-will employee should be entitled to save herself given that the firm has no obligation to save her. But, if the employee once enjoyed significant bargaining power, that employee can fairly be said to have assumed the risk of being tied down in a struggling or failing enterprise, and so the covenant should be enforced, assuming it is reasonable.

If this proposal might improve upon the present inconsistency, incoherence and inequities, the practical question is whether counsel and judges can use it, given a state’s extant precedents. A detailed analysis of each state is beyond the scope of this article, but at least for those that now regulate covenants under the common law rule of reason or under statutes that enact something similar to the common law, the four factors I have suggested are compatible with the rule of reason’s basic requirement that the employer must, above all things, demonstrate a legitimate interest. Judges, especially appellate
judges, could avoid counsel’s invitation to decide cases based on consideration and to short-circuit analysis of the facts concerning the parties’ economic interests and behavior.

Better opinions require specific attention to the problems, and temptations posed by, the procedural posture in which so many of these cases are decided. Many cases are decided as questions of law in response to motions for summary judgments, often with rather minimal fact-finding and in the hurried context of claims for injunctive relief. In these circumstances, trial judges may be forced to rely more on intuitions of who is a good actor and who is a bad actor (rather than probative evidence of probable economic injury to a legitimate business interest) and may be more inclined to rationalize or camouflage those intuitions through appeal to some available legal doctrine – such as the presence or absence of consideration. On appeal, if the reviewing court is unwilling to remand for further findings, it may have to choose between affirming or reversing a narrow and possibly contrived doctrinal ruling.

To the extent that narrow or implausible doctrinal opinions leave principles unsettled and holdings debatable, legal counsel are professionally bound to exploit these issues in litigation – for a typical example, by arguing the affirmative defense of a failure of

54 See Cornelius J. Peck, Penetrating Doctrinal Camouflage: Understanding the Development of the Law of Wrongful Discharge, 66 Wash. L. Rev. 719 (1991) (discussing in part the state court’s refusal to apply the doctrine of good faith and fair dealing to employment relationships that are at-will and providing the source for my use of the word “camouflage.”); see also Washington state cases discussed infra at [Part 3].

55 Judge Richard A. Posner, a self-described legal pragmatist, has criticized some judges for masking the grounds of decision in legal doctrine:

“There is a tremendous amount of sheer hypocrisy in judicial opinion-writing. . . . Judges have a terrible anxiety about being thought to base their opinions on guesses, on their personal views. To allay that anxiety, they rely on the apparatus of precedent and history, much of it extremely phony. I do think judges can and should get away with a lot more candor, so that the public sees what a court is—not geniuses, or even particularly erudite people, but just lawyers trying to give some reasonable ground for their opinions.”

consideration. If, as I argue, contract doctrines are not always helpful grounds for distinguishing between covenants that should be enforced from ones that should not, then only a legislature or a court of last resort can put an end to a cycle of mandatory arguments by advocates and trial courts’ attempts to choose among them, however peripheral they may be to resolution of an underlying and recurring source of conflict.

Now, this is a hard problem to fix because nobody – neither the parties nor the courts – wants to devote the time or resources to fuller fact-finding, much less a trial. Nevertheless, if appellate courts consider multiple factors and announce something like a four-factor standard rather than a rule for determining the significance of contract in these cases those opinions will probably discourage courts from issuing summary judgments on scant evidence. An explicit recognition that more multiple doctrinal and factual criteria are legitimately in play would encourage trial and intermediate appellate courts to explain the grounds of decision more fully. We may never get wholly predictable outcomes – until the way we organize work changes in ways that make these issues moot -- but we might get better precedents in the meantime, and ultimately fewer litigated disputes, if courts are willing to analyze the facts of enough disputes frankly so that employers and employees gain a better sense of what employer interests are protectible in different industries and what kinds of behavior before, during and after the employment are fair.

Moreover, courts and legislatures might review the rationales for deferring to private ordering in this context from an instrumentalist standpoint. In contemporary United States law, employers enjoy many other forms of legal protection for the proprietary information and goodwill that result from their investments in product development, marketing and customer service and in hiring and training the employees who develop the products, marketing strategies and provide the services. These protections include copyright,\textsuperscript{56} patent,\textsuperscript{57} trademark,\textsuperscript{58} and trade secret acts\textsuperscript{59} as well as common law duties of

loyalty\textsuperscript{60} and prohibitions on unfair competition.\textsuperscript{61} It may be that contractual restraints on former employees’ activities are the only way to protect a few especially inchoate interests that may not qualify for protection under a statutory or other common law regime. But for the many proprietary interests -- research data, negative “know-how”, marketing strategies, customer development and retention, etc. -- covenants and public laws will provide redundant substantive protections, and we might suspect that this will be more likely in the case of rank-and-file at-will employees. (It is important here to distinguish non-disclosure agreements and non-solicitation agreements from non-competition agreements. The former two are less likely to provide protections redundant with public law. In particular, under the uniform trade secret statute information only qualifies for protection if, among other things, the employer has made reasonable efforts to keep it secret.\textsuperscript{62} Thus, non-disclosure agreements may be necessary to secure trade secret protection. Non-solicitation agreements may be necessary to protect customer goodwill where the identity of customers is available from public sources and cannot qualify for trade secret protection.)

In many cases, however, the chief utility from the employer’s perspective of a covenant not to compete is procedural and normative. Although the covenant contract may only prohibit activities that would also be wrongful under public law, like theft of trade secrets, copyright, patent, or trademark infringement and false advertising, the contract permits the employer to sue for breach of terms it drafted and avoid the more demanding definitional and jurisdictional requirements of public law. The exercise of securing written assent to the covenant’s provisions also has the virtue of educating the employee to the employer’s expectations and probably creates a sense of personal obligation to abide by the promise.\textsuperscript{63}

\textsuperscript{60} See Restatement (Third) of Agency, supra note [9].
\textsuperscript{61} See Restatement (Third) of Unfair Competition, supra note [9].
\textsuperscript{63} See Arnow-Richman/Dilution, supra note 11 at 963, 966, 981 (arguing, in part, that the widespread use of standard form noncompete as conditions of hire dilutes employees’ already marginal bargaining power at the start and the end of the employment relation, in part, by normalizing the employer’s definitions of employee rights).
If the employer could protect its legitimate interests under public law, the major rationale for using covenants to protect employer investments must be their normative impact on the workplace and the relative ease of pleading breach of contract. The question, then, is whether the public interest is served by according employers this additional means to protect investments that for the most part are already protected by statutes and tort doctrines. To the extent that an interest is not protected by public law, or it is hard to know in advance whether it will be protected, then private contractual ordering may be preferable to public law regimes because the parties can define their goals, determine what they do and do not know, and allocate risks accordingly. Otherwise, employers have no reason, apart from their own convenience, for protecting their interests via contract.

As to setting norms, employers can announce their expectations and describe internal and public law sanctions without requiring the employee to respond with a promise never to make the sanctions relevant.

There are two reasons to suspect that private ordering may not protect the public interest when employers require covenants not to compete from at-will employees. First, such an employee may not have had the ability to bargain for restraints tailored to her position or for additional compensation to compensate her for the particular risk that she may be sued for breach of contract even though her activities may not ultimately be deemed injurious to the employer’s legitimate interests. Instead, the covenant may be adhesive, presented by the employer as a condition for employment or continued employment on take-it-or-leave-the-job terms. Unless large-market conditions exist for comparable jobs in her field, we may have reason to doubt that market competition for workers will pressure employers to trim covenants’ restraints to the minimum scope necessary to protect their legitimate interests. Although a covenant’s restraints may be greater than an alert court would ultimately enforce, the employee will have the burden to produce evidence that this is so. The point is not that the at-will employee cannot be bound because there was no formative bargain; the point is that the formative bargain may not be probative of the covenant’s propriety.
Second, the employee’s at-will status allows the employer relatively unfettered power to alter the terms and conditions of employment, perhaps disadvantageously, while yet insisting upon the post-employment restraints to which she assented. In most states, a facially valid covenant endures in effect even though the caliber of the associated at-will employment has changed, perhaps for the worse. In altering the terms of the employment, however, the at-will employer breaches no obligation unless its actions violate a public law. But, at the same time, the covenant’s restraints on post-employment activities, which the employer has subjectively defined as unduly competitive, may present a major obstacle to an at-will employee’s most significant bargaining chip – the power to quit.

This leverage should raise concerns beyond the specter of the occasional employer acting in bad faith. In fact, it may insulate employers who are acting in good faith from the employee flight that would otherwise occur when a business is failing. It may deter employee insiders, with good information about the business’s prospects, from voting with their feet. For example, during economic recessions or during periods of consolidation within an industry, merging, downsizing or struggling firms may, in good faith, demand more productivity of at-will workers who remain employed, while they hold down or even cut wages or benefits. Unless an employer’s alteration of the terms and conditions of employment violates a public law, such as a wage and hours act or an anti-discrimination statute, an at-will employee’s only formal recourse is exit. If the employee has assented to a non-compete, however, she may have little practical power to exit if reasonably comparable alternative employment creates the risk of a lawsuit or

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64 See Leibman & Nathan, supra note [28] at 1548 -1558 (suggesting that the unconscionability doctrine might provide a corrective where an employer unilaterally diminishes the quality of an employment after a covenant is signed.) Since their 1987 article, however, unconscionability does not often appear as an explicit affirmative defense. See Vanko, supra note 7 (surveying and analyzing cases involving disputes over whether an employer may enforce a covenant despite having terminated the employee involuntarily. The article identifies no category of cases resolved on grounds of unconscionability.) Indeed, it is hard to imagine how a court would rationalize finding covenant substantively or procedurally unconscionable merely because an employer exercises retained at-will prerogatives. See, e.g. Kupcnzov v. Blasters, Inc., 647 So. 2d 888, 891 (Fla. Dist. Ct. App. 1994) (noting possibility of an unconscionability defense if an employer discharged or otherwise harmed an employee’s interests very shortly after procuring a covenant but not finding unconscionability where the employee had been employed and well-paid for many years before his commissions were reduced.) See cases discussed infra at [Part 3].

possible unemployment should a potential new employer be frightened off by the prospect of litigation. As a result, the individual may lose opportunities to advance her career and compensation, and the employer may be able to insulate itself at least temporarily from the competition of more vibrant enterprises for productive employees.

The point is not that the covenant is necessarily inefficient in these circumstances, but it may be. It may enable an inefficient employer to hold onto at-will employees without paying market rates of compensation when those rates are rising. This leverage seems especially unfair because, in contrast to its obligations to a contract employee, the employer’s relatively unfettered power to discharge the at-will employee provides no offsetting security when market rates of compensation fall. The inability of most rank-and-file at-will employees to finance any litigation, much less mount the kind of evidence that might show that an employer’s covenant restraint was actually sheltering inefficiency or postponing inevitable failure, means that few courts will even glimpse such scenarios. It doesn’t mean that they don’t exist.

Of course, a state could remove the employer’s advantages through a legislative ban on enforcement of employee covenants not to compete, as California has done.\(^\text{66}\) Arguably, however, a ban cuts too wide a swath, preventing some individuals from bargaining for additional benefits in exchange for restraints on their personal capacities to compete.\(^\text{67}\) Moreover, the prospects that most state legislatures will be moved to copy California’s ban seem slight since chambers of commerce and other industry groups are likely to oppose a ban and are better organized than at-will employees.

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\(^{66}\) \textit{Cal. Bus. \\& Prof. Code} §16601, \textit{supra} notes [16 \\& 17]. \textit{See} Edwards II v. Arthur Andersen LLP, \textit{supra} note [17][189 P.3d 285, 293 (Cal. 2008)] (holding that there is no exception to the state statute’s ban on enforcement of employee covenants not to compete).

\(^{67}\) \textit{See, e.g.,} Leibman \\& Nathan, \textit{supra} note [28] at 1564 – 1569 (arguing that covenants should be enforced on basis of an employee’s expectation of a benefit from the employment); Stewart E. Sterk, \textit{Restraints on Alienation of Human Capital}, 79 Va. L. Rev. 383, 454 – 56 (1993) (arguing, in part, that failure to enforce restraints on use of human capital disadvantages young and talented workers who benefit from being able to secure training and benefits in exchange for promising not to deploy their talents elsewhere.)
My four factor proposal is less drastic and more realistic because most states courts already have discretion to implement it. It simply mitigates any formal or de facto presumption that a covenant’s terms are valid simply because an employee at-will has assented to them. To avoid the effects of that presumption, whether it is formally recognized or more an habitual reaction to a signed contract document, a trial court could insist that the employer produce a precise statement of the economic justification for the restraint at the time of pre-trial proceedings on the merits. Initially, the court should review the covenant’s terms and the process by which the employee’s assent was obtained solely for the purpose of determining that the employee had proper notice that her post-employment activities would be constrained if she chose to accept or remain in the job and that the notice did not overstate the employer’s rights. In other words, the court should treat the employer’s claim as if it sounds in tort rather than contract -- the employee’s liability, if any, arising from a duty to behave reasonably with respect to the employer’s announced and legitimate economic interests and not from a distinct and additional duty to abide by the covenant’s terms, even though the employer has enacted the process and form of contract. If the employer’s economic justification proves not to be well-grounded in a good-faith reading of law and a credible factual analysis, then the case should be dismissed. In egregious cases, the employer might be subject to sanctions.

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68 It is important to distinguish among presumptions. A thorough analysis is beyond the scope of this article, but I will mention a likely source of confusion. The conventional black letter common law rules require that a covenant’s terms be reasonable and consign that determination to the court as a matter of law. That would suggest that there is no presumption that a covenant’s terms are enforceable. However, in the Restatement framework, the issue of whether a covenant contract has been formed precedes the question of whether the terms are reasonable. See RESTATEMENT (SECOND) OF CONTRACTS, supra note [3] at §§ 186 – 188. Under conventional contract doctrine and pleading rules, a party must plead an affirmative defense, such as a failure of consideration or illegality, to void the contract ab initio. See, e.g. Fed. R. Civ. Pro. 12(b)(6). In ordinary contracts, if an affirmative defense fails, then normally there is a presumption that a contract should be enforced according to its terms and that the party resisting enforcement bears at least the burden to generate an issue of fact that the terms do not mean what they seem or some similar argument. If that presumption for regular contracts is extended to covenant contracts, it seems to be somewhat inconsistent with the Restatement position that reasonableness is a matter of law for the court. See., e.g., Scott v. General Iron & Welding Co., Inc., 368 A.2d 111, 115 – 16 (Conn. 1976) (stating that burden of proof (not just production) is on defendant employee to show covenant is unenforceable because overbroad); accord Braman Chem. Enter., Inc. v. Barnes, 2006 WL 3859222 (Conn. Super 2006) (holding that an employee seeking declaratory judgment that covenant is unenforceable for overbreadth has burden of proof.) My research has not revealed another jurisdiction that put these burdens so explicitly on the employee.
This proposal is consistent with the long-standing common law tradition of substantive regulation of private restraints of trade and consistent with economic and legal scholarship. It has the virtue of deferring to private ordering when market factors give us reason to think that employees’ self-interest and bargaining capacity are likely to reduce covenant restraints to the minimum level essential to preserve the employer’s investments in training, product development and customer service, but it avoids the vice of pretending that every instance of private ordering operates in the same way and should be evaluated with one set of rules. That individuals’ effective informational and economic capacities should affect the legal measure of their personal obligations is such an obvious point that it hardly seems worth writing – except that some lawyer and judges have trouble doing just that.
Part 3

This Part describes and compares several recent cases in which the facts suggest that the dispute over the covenant not to compete was complicated by a deterioration in the employment relationship that may have motivated the employee’s exit as much or more than any desire to compete. My goal is to show that appellate courts lack a coherent framework for resolving these kinds of disputes fairly and coherently if they rely exclusively on contract doctrine, especially in those cases involving employees at will. The opinions in which courts acknowledge other equitable considerations openly are more coherent, but there has yet to emerge a consistent theory about whether or why a deterioration in the employment should have any bearing on enforcement of a covenant.

I begin with an opinion from the Washington State Supreme Court in 2004 because it so vividly illustrates the pitfalls of trying to resolve one of these disputes on the basis of contract formation doctrine without investigation of the employer’s need for the restraint or the grounds for its treatment of the employee between his assent to the covenant and his alleged violation of it. It also reveals how constrained counsel and courts may be, or at least may imagine themselves to be, by a body of inherited precedent whose factual resemblance to contemporary disputes may be quite superficial.

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69 Labriola, supra note [8]. [Labriola v. Pollard Group, Inc., 100 P.3d 791 (Wash. 2004)] [Note to editors: In the notes in Part 3, I have not referred back to note 8 because it seemed cumbersome to refer readers back. Instead, the notes are referenced directly to the appellate opinion or the trial record as appropriate.]

70 In this respect, it may be that the rhetoric (in the classical meaning relating to the elements of persuasive argument, and not just style), as much as the holdings, of seminal precedents in a state has a significant and continuing impact on the tenor of contemporary opinions. Compare, for example, the broad historical perspective and grand style of Kadis v. Britt, 29 S.E.2d 543 (N.C. 1944) (refusing to issue an injunction to enforce a covenant against a modest door-to-door delivery man made after a considerable period of employment at-will with no additional consideration) with the narrower doctrinal focus and constrained style of the majority opinion in Wood v. May, 438 P.2d 587 (Wash. 1968) (modifying the covenant to terms the court thought reasonable and granting an injunction enforcing a post-hire covenant against an employee at-will who had been hired to shoe horses). Cf. Collier Cobb & Assoc., 300 S.E.2d 583, 586 (N.C. Ct. App. 1983) (following the holding of Kadis v. Britt and using a more modern but similarly expansive fact and common-sense rhetoric in its analysis). The formalist tenor of the opinion in Labriola is consistent with that in Wood, and we might speculate that precedents in a given state control not only subsequent holdings in a formal, legal-method sense but may also influence the range of analysis, reference and the tone that a later court may think proper. The caliber of opinions may also correlate with the role clerks play in drafting an opinion. Recent graduates of law schools will likely be familiar with the doctrine of

“Should I Stay or Should I Go?”

Law Review Submission draft August 6, 2009
Anthony Labriola, an at-will salesman for Pollard Group, a commercial custom printing business in Tacoma, Washington, filed suit for a declaratory judgment that a covenant not to compete was unenforceable on one of two grounds: lack of consideration or the employer’s breach of contract.\(^{71}\) The trial court not only refused to grant the declaratory judgment but also granted a partial summary judgment to the employer that the covenant was supported by consideration and was enforceable.\(^{72}\) The trial court also refused to reduce the covenant’s duration from three years to six months.\(^{73}\)

The state supreme court granted a direct review\(^ {74}\) and reversed the trial court on the sole ground that the covenant was not supported by consideration.\(^ {75}\) In doing so, in my view, the state’s court of last resort missed an opportunity to establish a cogent precedent for the future. It failed to give a clear answer to the question of exactly when or why at-will employment may be sufficient consideration for a covenant; it failed to mention that, on its face, the covenant was more restrictive than necessary to protect any legitimate interest Pollard might have had; it ignored a credible argument that Pollard used the leverage its covenants afforded to depress at-will sales employees’ commissions (or to make them work harder); and it expressed no discomfort that an earlier covenant, formed at initial hire, would remain in force despite the use of that leverage. This judgment was an expedient way to reverse the lower court which had seemed to find only the consideration from contracts courses and the bar exam – and may be inclined to overestimate its merits -- but they may not be familiar with employment law, jurisprudential theories, or legal history. The range of reference in seminal authorities will likely control their analyses to a remarkable degree.

\(^{71}\) Labriola, 100 P.3d at 793. The supreme court’s description of the procedural background does not reveal that at the trial court Labriola challenged the covenant on two grounds – failure of consideration and breach of contract by the employer. Pl. Compl., id. (No. 74001-0). See also Pl’s Mem. Supp. Mot. Partial Summ. J., id., 2003 WL 25740129 (Wash. Super. Ct.). Nor does the supreme court’s opinion reveal that on appeal Labriola alerted the court to the employer’s alleged plan to alter the commission schedule in his brief, stating the second issue for review as:

Should the trial court have denied plaintiff’s motion of summary judgment and granted defendant’s motion for summary judgment in light of the fact that following execution of a “Noncompetition and Confidentiality Agreement,” the defendant announced its intention to cut plaintiff’s commissions radically, reducing his pay by approximately 25% (assuming consistent sales)?


\(^{72}\) Labriola, 100 P.3d at 793; see also Tr.Mot. Hr’g, Clerk’s Papers (hereinafter CP) 3-22, 30 (No. 74002-0).

\(^{73}\) Labriola, 100 P.3d at 793.

\(^{74}\) Id.

\(^{75}\) Id., 100 P.3d 791, 797.
consideration issue relevant, but in reversing solely on that issue the court paradoxically reaffirmed a message that the consideration issue, alone, could resolve the conflict that led to the dispute. Among other missteps, the majority failed to address whether Pollard had any legitimate interest to protect or whether Labriola’s attempt to work for another printer threatened such an interest. My intuition is that the court was, in fact, disturbed by evidence that Labriola wanted another job because Pollard proposed to lower his commissions. However, the court may have felt it had no doctrinal basis for treating that evidence as significant because Pollard, as an at-will employer, had the right to alter commissions. And so, I think the opinion is unpersuasive because the court wanted to avoid what might be a politically controversial judgment that an at-will employer ought not to be able to enforce a covenant in such circumstances.

The dispute between Labriola and the employer Pollard began in the summer of 2002. Labriola had worked for Pollard since 1997 as a salesman. Labriola’s status, like that of the other sales personnel, was at-will, except that Pollard promised to give ten days notice of termination. When Labriola was hired as a novice print salesperson,\(^{76}\) he had signed an agreement that barred disclosure of confidential information and seemed to bar soliciting Pollard’s customers for three years after termination.\(^{77}\) The supreme court did not analyze this agreement or its continuing significance, if any, because it said that Labriola’s counsel conceded during oral argument that the ban on customer solicitation was enforceable.\(^ {78}\)

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\(^{76}\) Def. Pollard Group, Inc.’s Opp’n Pl.’s Mot. Partial Summ. J., 2003 WL 25740134 (Wash. Super. Ct.) (asserting that “[w]hen the Plaintiff came to work for Pollard and signed the first covenant not to compete, he knew little if anything about sales of commercial printing.”). [at p. 15 WL printout.]

\(^{77}\) See id. for the key clauses of the 1997 Agreement.

\(^{78}\) Labriola, 100 P.3d at 796. The court’s reliance on a concession supposedly made in an appellate oral argument seems questionable, particularly in light of the fact that the enforceability of a covenant not to compete is ultimately a question of law for the court and not within the power of either party to concede. Moreover, the significance of this earlier agreement is unclear and the court’s passing reference to it does nothing to clarify it. Presumably, the legal analysis would be that the earlier agreement remained in effect if the 2002 Agreement was void. The 2002 agreement purported to supersede the 1997 one, Labriola Decl. Exh. C. Par. 12. Arguably, if the 2002 agreement failed for lack of consideration then it never took effect and never superseded the 1997 agreement. In the proceedings at the trial court, Pollard clearly anticipated and tried to establish the foundation for this outcome. Its peculiar emphasis on the 1997 agreement, while ostensibly purporting to defend the 2002 covenant, may have been a pragmatic effort to lay the groundwork for a claim that Labriola, and the rest of the sales force, remained bound even if the 2002 Agreement were found void. Def. Pollard Group, Inc.’s Opp’n Pl.’s Mot. Partial Summ. J., 2003 WL 25740134 (Wash. Super. Ct.) [at p. 1-2 WL printout.]
Almost five years later, in April 2002, Pollard presented its sales employees with a new agreement – this time a full-scale covenant not to compete.\textsuperscript{79} It purported to bar employees from working in any capacity for any competitor of Pollard’s within 75 miles for three years after termination,\textsuperscript{80} and it purported to supersede the 1997 restrictions.\textsuperscript{81} By its terms, an employee’s assent was made a condition for continued employment. In a

\begin{quote}
In any event, the supreme court refers to the 1997 agreement as a “restrictive covenant not to compete in the custom printing business for a period of three years after employment ended,” but there is no indication in the record that the terms were that broad. The court quoted the relevant paragraph 10 as follows:

For a period of three years after the termination of this Agreement for any reason, the Employee shall not contract [sic], in any manner, for any reason, for or on behalf of any person or entity engaged, or intending to engage in, a custom printing business, any customer, or prospective customer of the Employer whose name is contained on any customer list which is part of the confidential information described above.[sic]

Labriola, 100 P.3d at 792, note 2 (citing CP at 12) . (No. 74002-0.)

In the Clerk’s Papers, however, the verb reads “contact,” not “contract.” With that correction, the paragraph seems intended to be a ban on customer solicitation: “[T]he Employee shall not contact…any customer.” Even with this correction, however, the meaning is uncertain due to what seems to be a misplaced comma between “in” and “a custom printing business.”

I delve into the meaning of this purported agreement to highlight how inept the drafting was and to call attention to the fact that neither party could really have been sure of the meaning of the document, whether or not they had agreed to it in a process that would meet contract formation rules. Retrospective judicial analyses tend to accord great respect to the bargain between the parties, but the ambiguities in this clause give the lie to the idea that lay contractors, perhaps especially in small businesses, always are paying much attention.

\textsuperscript{79} Paragraph 5 of the 2002 Agreement read:

5. Agreement not to Compete

5.1 Restrictions during and after termination of Employment. Employee agrees that (a) during Employee’s employment by Employer; and (b) after Employee’s employment with Employer is terminated for whatever reason, Employee shall not, without the express written consent of Employer, directly or indirectly, as owner, employee officer (sic), director, consultant, independent contractor, partner, stockholder, and investor or otherwise:

5.1.1 Conduct any business or perform any work in competition with the services, sales and products of Employer;

5.1.2 Become employed by any business competing with Employer to provide services, sales or products that are substantially similar to those provided by Employer; or

5.1.3 Conduct any business or accept any employment that interferes with Employee’s duties to Employer.

Labriola, CP at 17.

\textsuperscript{80} Labriola, 100 P.3d at 792

\textsuperscript{81} Id.

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deposition, Labriola said that he understood this, and Pollard made no attempt to deny that it would have discharged employees who did not sign. In fact, Pollard’s counsel joined the issue head on, arguing expressly that the wording of the agreement and Labriola’s subjective understanding that future employment was conditioned upon assent demonstrated the existence of consideration as a matter of fact and of state law.\textsuperscript{82}

Labriola was given a few days to review the agreement, with counsel if he desired. In the event, he, and all the other sales personnel, signed the new agreement at the end of April apparently without registering any objections.\textsuperscript{83}

About three months later, in July, Pollard’s president presented the sales force with a new commission schedule that was to take effect later that year. It would raise the minimum sales threshold for receiving commissions from $25,000 to $60,000 per month. Labriola alleged that it would have reduced his total income by about 25 percent, assuming his sales volume held steady.\textsuperscript{84} Labriola objected to the new schedule and began to look for other employment, including having some discussions with ESP, a competitor of Pollard’s within the 75 mile limit.\textsuperscript{85} (As a practical matter, Labriola probably would have had to change careers or move house in order to avoid a very long commute and also comply with the 2002 covenant. All the reasonably sized cities and likely sources of work for a printing salesman in the Puget Sound region – Seattle, Bellevue, Redmond, Everett, Olympia – are within 75 miles of Tacoma. Other cities are substantially farther away. The largest, Portland, Oregon, is about 140 miles to the south. Some smaller cities include Yakima 150 miles southeast, Bellingham 122 miles north, and Spokane nearly 300 miles to the east.)

\textsuperscript{83} Def. Pollard Group, Inc.’s Opp’n Pl.’s Mot. Partial Summ. J., 2003 WL 25740134 (Wash. Super. Ct.) ([at p. 2 WL printout]. One wonders whether voicing objections would have been an acceptable thing to do in this company. See Arnow-Richman/Dilution, supra note [11], for a discussion of at-will employees’ bargaining power once employed.
\textsuperscript{84} Labriola, 100 P.3d at 792 – 93.
Discovering Labriola’s plans to leave, Pollard notified ESP of the covenant, and ESP did not hire Labriola. Pollard also fired Labriola. Pollard alleged that Labriola had job-hunted during working hours and that he had violated the agreement by contacting at least two of Pollard’s clients and informed them of his plans to leave. Pollard also accused Labriola of taking documents without permission from Ron Pollard’s office although the record does not reveal what they were. (Labriola seemed to concede taking the covenant which Labriola gave to ESP and eventually his lawyer.) According to Pollard, Labriola discussed his plans to leave with other employees and was going to “lead the charge” to demonstrate that the covenant not to compete was unenforceable. In the event, Labriola remained unemployed for the duration of the litigation although the supreme court found that he had made reasonable efforts to secure appropriate substitute employment.

In short, it was a nice mess – with enough bad behavior, mutual resentment, and poor judgment to fuel litigation.

In the trial court, both parties moved for partial summary judgment. At a hearing on the motions, the trial court denied the plaintiff’s motion in part and granted the defendant’s motion in part. The trial court held the covenant was enforceable, specifically rejecting the plaintiff’s argument that consideration was lacking and adopting defendant’s argument that continued employment of an at-will employee was sufficient consideration. The court also refused to reduce the covenant’s term from three years to

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89 Pollard’s brief to the supreme court asserted that it was undisputed that Labriola contacted customers and discussed whether they would go with him, and also that he “informed other Pollard employees that he was going to work for a competitor of Pollard’s, that he intended to make Pollard ‘pay’ and that he was going to lead the charge to have the April 2002 Agreement declared invalid.” Resp’t’s Br. at 36.
90 Labriola, 100 P.3d at 797.
92 Tr.Mot. Hr’g, CP at 3-22, 30 (No. 74002-0).
six months.\textsuperscript{93} The trial court seemed to assume that the covenant protected a legitimate interest and that it was reasonable in scope,\textsuperscript{94} although plaintiff’s counsel must share some of the blame for those assumptions if they were unwarranted. He failed to raise either issue clearly at the pleading stage in his memorandum in support of Labriola’s motion for partial summary judgment, nor did he generate any issues of fact in that memorandum to block Pollard’s own motion for partial summary judgment.\textsuperscript{95}

Labriola’s counsel did, however, succeed in making a clear factual argument to the trial court that the employer had used the leverage afforded by a covenant not to compete to lower the commissions it would pay its at-will sales force,\textsuperscript{96} but counsel tried, in vain, to persuade the trial court to take this argument seriously. One reason -- significant for my thesis -- was that he had trouble articulating any legal theory for why this leverage was improper. He initially tried to persuade the trial court that Pollard had breached some sort of contractual obligation to Labriola.\textsuperscript{97} The trial court, however, seemed to think the

\textsuperscript{93} Labriola, 100 P.3d at 793.

\textsuperscript{94} See Tr.Mot. Hr’g, CP at 4-31 (No. 74002-0).

\textsuperscript{95} See Pl’s Mem. Supp. Mot. Partial Summ. J., 2003 WL 25740129 (Wash. Super. Ct.) in which counsel never makes the argument that the covenant serves no legitimate purpose or that, if it does, it is facially overbroad.

\textsuperscript{96} “Several months after acquisition of the [covenant not to compete], defendant, apparently emboldened by its acquisition of the [covenant] made an aggressive move against its commissioned salespeople. Defendant unilaterally announced a new commission sales compensation schedule.” \textit{Id.} [at p. 2 of WL printout]. Plaintiff alleged that the new schedule would lower plaintiff’s income by 25 percent, assuming sales remained constant. \textit{Id.} [at p. 3 of WL printout].

\textsuperscript{97} In his trial memorandum counsel seems to argue that maintenance of the existing commission schedule was an implied term of Labriola’s covenant not to compete. He elided the issue of whether Pollard had provided any consideration to induce agreement to the covenant with the issue of whether the subsequent change in commission rates was a material breach of some agreement. “Giving the defendant the benefit of every conceivable doubt, it may be able to say that Tony Labriola agreed not to compete for three years following his termination so long as he was paid according to the existing compensation structure at the time the Agreement was entered into. However, Labriola never agreed to work under the onerous terms of the noncompete agreement for 25 \% less than what he had been originally promised. Thus, even if the court were to determine that there was some marginal consideration sufficient to uphold the noncompete (a concept which the plaintiff bitterly contests) when Pollard cut his pay by more than one quarter it breached the agreement. Labriola \textit{never} agreed to forgo the right to compete against Pollard for the radically reduced commission pay schedule which was imposed upon him only months after the noncompete was entered into.” \textit{Id.} at WL printout 6 - 7.
alteration of the commissions was relevant, if at all, only to the issue of consideration for formation of the covenant, stolidly commenting about the proposed schedule, “Hang on a second. None of that matters. That happened after the April signing.”

Labriola appealed directly to the state supreme court, asserting two issues for review. The first essentially repeated his arguments on failure of consideration. This time he avoided his earlier attempt to characterize Pollard’s behavior as a breach of contract. Instead, he simply presented the second issue as follows:

Should the trial court have denied plaintiff’s motion of summary judgment and granted defendant’s motion for summary judgment in light of the fact that following execution of a “Noncompetition and Confidentiality Agreement,” the defendant announced its intention to cut plaintiff’s commissions radically, reducing his pay by approximately 25% (assuming consistent sales)?

Nonetheless, without even mentioning this issue, the state supreme court reversed the trial court solely with respect to the consideration holding. The opinion contained no discussion of the legitimacy of Pollard’s interests, no discussion of the reasonableness of the geographical and temporal restraints, and no analysis of plaintiff’s second issue for review – not even a statement that it was moot due to the dismissal for failure of

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At the motion hearing, counsel attempted to argue that the new commission schedule, which had not been put into effect when Labriola was fired, was an “anticipatory breach” of this implied term. Tr.Mot. Hr’g, Clerk’s Papers, CP at 4 - 31 (No. 74002-0). This contract argument was not destined for success since counsel had no written or oral evidence that Pollard had agreed to maintain commission rates, and his effort to construct an implied obligation based on Labriola’s (reasonable) expectations ran straight into Washington strong presumption in favor of employment at-will. See, e.g., Bulman v. Safeway, Inc. 27 P.3d 1172 (Wash. 2001) (refusing to recognize an at-will employee’s claim based on allegation of an implied contract arising out of an employer’s promulgation of a progressive disciplinary policy.) Washington courts have even refused to recognize an implied duty of good faith and fair dealing in at-will employment relations. Willis v. Champlain Cable Corp., 748 P.2d 621 (Wash. 1998) (denying an employee’s claims to unpaid commissions where employer terminated his employment at-will in bad faith to avoid obligation to pay commissions). See also Peck, supra note [54] (criticizing the Washington court for exempting employment relations from the general duty of good faith and fair dealing).

98 Tr.Mot. Hr’g, Clerk’s Papers, CP at 15 (No. 74002-0).
consideration. The commission schedule is mentioned in the statement of facts\textsuperscript{100} but the court’s analysis gives no hint that it has any legal significance, except perhaps to the extent that one might infer an oblique criticism of Pollard’s conduct in a conclusory remark at the end of the opinion that, while continued employment or training might provide consideration for a covenant, “it certainly was not the case here.”\textsuperscript{101}

In a separate opinion, one justice concurred in the judgment but faulted the court for having failed to explain the consideration requirement accurately and for failing to note, as an independent ground for relief, that the covenant was unreasonably restrictive in barring Labriola from working for a competitor in any capacity regardless of whether he would take “unfair advantage” of Pollard. The concurring justice comes close to adopting plaintiff counsel’s second ground for relief and echoes my thesis about the impropriety of an employers’ leverage in a case like this, writing that the covenant “represents an unfair attempt to stabilize Pollard’s workforce and secure its business against legitimate competition.”\textsuperscript{102} Unfortunately, the concurring justice points to nothing in the record to support that intuition other than the covenant’s facial overbreadth.

There are many criticisms that might be made of the lawyering and of the judging in this case, but for my purposes the most important questions are why the court seemed to ignore Labriola’s argument that Pollard misused its leverage and whether that was an appropriate response by the state’s court of last resort to an issue of this kind.

The judgment may seem employee-friendly, but the precedential effect is at best insignificant and at worst obfuscatory.\textsuperscript{103} In its aftermath, any minimally alert employer can construct legally sufficient consideration should it need to. The trial court’s decision

\textsuperscript{100} Labriola, 100 P.3d at 792 – 96.

\textsuperscript{101} Labriola, 100 P.3d at 796.

\textsuperscript{102} Labriola, 100 P .3d at 798 – 800 (Madsen, J. concurring).

\textsuperscript{103} Other state’s courts have followed Labriola for the proposition that continued employment at-will, standing alone, is not consideration for a covenant not to compete, while maintaining that initial hiring is. See, e.g., Access Organics, Inc. v. Hernandez, 175 P .3d 899 (Mt. 2008); Lucht’s Concrete Pumping, Inc. v. Horner, __ P.3d__, 2009 WL 1621306 (Colo. Ct. App.). [Ed. Note: both case cited initially in note 4.]
was surely faulty not so much for its judgment about consideration, which had logic if not wisdom on its side, but for the judgment that the covenant was enforceable without any inquiry into Pollard’s interests or Labriola’s capacity to injure them by working for a competitor. The trial court compartmentalized its contract analysis so that it never considered whether Pollard’s alteration of the commission schedule might be relevant to the legitimacy of its claim that the covenant was enforceable. Paradoxically, the state supreme court’s narrow ground of decision may encourage lower courts to continue to focus excessively on the presence or absence of consideration and overlook more serious substantive problems.  

A conventional defense of the state supreme court’s decision might be that consideration was a narrow, legal ground for dismissing the case entirely. The court avoided the possible need for a remand to the trial court for the time-consuming and possibly expensive factual determination of whether Pollard had a legitimate business interest,

104 See, e.g., KGB, Inc. v. Herbert, 2008 WL 2076207 (Wash. Super.) (modifying and enforcing a covenant not to compete, including a liquidated damages clause, against a six-month employee of a “drain and rooter” service who set up his own drain and rooter business seven months after quitting.) The reasoning in the trial order is obscure, at best. The court gave judgment to the employer despite finding that the employer had not provided significant training nor that the employee had been employed long enough to become a “familiar face” to customers. The judgment seems particularly odd in finding that “since there is limited repeat business in this filed… it cannot be said that it is unreasonable to restrain the defendant from using customer contracts gained through his employment.” The trial order notes only that the defendant had placed ads in local media, not that he had solicited customers. The order rejects the defendant’s argument that the agreement lacked consideration because it was signed four or five days after the defendant had begun to receive training, distinguishing Labriola on the ground that the covenant there was overbroad and had been demanded after five years of employment. I suspect that, had the state supreme court emphasized the basic requirement of a legitimate business interest, this decision might have come out differently and certainly been better reasoned. In general, federal courts, applying Washington law, seem more inclined to determine whether the employer had a legitimate business interest and to resist entanglement in the consideration issue. See Ossur Holdings, Inc. v. Bellacure, Inc., 2006 WL 3434440 (W.D. Wash.) (unpublished opinion) at *6 (following Labriola in holding a post-employment modification to a covenant not compete unsupported by consideration but devoting most of the opinion to an analysis of whether enforcement was necessary to protect the employer’s legitimate interests); Lord Corp. v. Henricks, 2005 WL 1838310 (W.D. Wash.) (Opposition to Plaintiff’s motion for Temporary Restraining Order, Expedited Discover and Preliminary Injunction) (refusing to issue an injunction under Washington law to prevent an ex-employee from working until conclusion of a trial on the merits of the covenant was concluded in North Carolina and giving as only one ground that a post-hire supplement to the ex-employee’s covenant was unsupported by consideration but devoting most of the analysis to the legitimacy of the employer’s claim and its likelihood of success on the merits). Microsoft Corp. v. Lee, No. 05-2-23561 SEA, 2005 WL 4932161 (Wash. Super. Ct. Sept. 15, 2005) (Order granting preliminary injunction), discussed supra at note [29], provides a counter-example of a Washington State court putting more emphasis on the merits than on the consideration issue.
what the scope of an appropriate restraint might be, and whether Pollard had misused its leverage afforded by the combination of the covenant and at-will employment to impose a pay cut and deter exit. In fact, however, due to Labriola’s concession during oral argument, the supreme court’s judgment arguably restored the force of the 1997 agreement prohibiting client solicitation, and so, the court left outstanding the question of whether an employer may combine the force of a covenant, albeit a less burdensome one, with its unilateral powers as an at-will employer to reduce compensation.

105 Washington courts will enforce an employee covenant not to compete to the extent it is reasonable and will revise (“blue pencil”) excessive terms to make them reasonable, regardless of whether the excessive restraints are syntactically separable. Wood v. May, 438 P.2d 587, 590-91 (Wash. 1968). This practice may limit excessive restraints once challenged, but arguably it increases the employer’s leverage since employees may believe the excessive restraints are legally binding or are too risk-averse to challenge them. Ironically, it is also inconsistent with decision-making otherwise focused on enforcing promissory undertakings as defined at contract formation.

106 This outcome may be thought acceptable, regardless of Pollard’s later treatment of Labriola’s compensation, if Labriola’s relationships with customers were such that he could divert them from Pollard. Pollard’s counsel suggested that Labriola had those kind of relationships in an artful sentence that did not quite assert that they were: “The Plaintiff cannot possibly assert that commercial printing is not a trade which involves a unique personal relationship between a tradesman and a customer.” Def. Pollard Group, Inc.’s Opp’n Pl.’s Mot. Partial Summ. J., 2003 WL 25740134 (Wash. Super. Ct.) [at p. 15 WL printout], but neither the trial court nor the supreme court demanded evidence that this was so. That evasion of a key issue was enabled by the holding on consideration.

Washington’s case law on the nature of customer relationships that justify a post-employment restraint is not well-developed or clearly articulated. In Perry v. Moran, the court was willing to enforce a covenant that precluded the former employee from servicing former clients of the employer, even though there was no evidence that she had encountered them while working or solicited them directly, 748 P.2d 224 (Wash. 1987), modified 766 P.2d 1096 (Wash. 1989), but a persuasive dissent suggested that the court had misapplied earlier authority and that the employer did not have a legitimate interest in restraining service of clients with whom the employee had not come in personal contact. 748 P.2d at 706-7 (Utter, J., dissenting.). Cf. Wood v. May, 438 P.2d 587, 589 (Wash. 1968) (quoting 9 A.L.R. 1467, 1468 for the principal that “[i]t is clear that if the nature of the employment is such as will bring the employee in personal contact with the patrons or customers of the employer, or enable him to acquire valuable information as to the nature and character of the business and the names and requirements of the patrons or customers, enabling him, by engaging in a competing business in his own behalf, or for another, to take advantage of such knowledge of or acquaintance with the patrons or customers of his former employer, and thereby gain an unfair advantage, equity will interfere in behalf of the employer and restrain the breach of a negative covenant not to engage in such competing business.”) If we assume that Labriola’s relationships were of that caliber, then the propriety of the restraints rests as much on the public interest in protecting Pollard’s investment in goodwill as it does on enforcing Labriola’s promise, as such. See also Nat’l Sch. Studios, Inc. v. Superior Sch. Photo Serv., 242 P.2d 756, 760-1 (Wash. 1952) (refusing to award damages against a former employee who solicited employer customers in part because customers’ identity was available from public sources like directories.); cf. Outsource Int’l., Inc. v. Barton, 192 F3d 662, 669 – 674 (Posner, C.J. dissenting) (describing Illinois state cases that limit the legitimate employer interest in customers to those where the former employee had a “near permanent” relationship with the customer.)

In any event, a decision to enforce the 1997 agreement could be grounded on the legitimacy of the employer’s investment in developing customer goodwill through Labriola’s employment, if there were
Another defense of the court’s opinion might be that it merely responded to the consideration issue as the parties had framed it. Arguably, the issue arose from an ambiguity in state precedents which the court of last resort may have felt obliged to resolve. But rather than resolve the ambiguity, the court repeated the analytic and semantic steps that had generated it. The court held that Labriola’s continued employment at will did not provide sufficient consideration for the signed non-competition contract, but the opinion reaffirmed existing Washington case law that held that an initial hiring at will is sufficient consideration.

Evidence that he had the kind of relationship with customers that would incline them to do repeat business with Pollard. Such a decision would be consistent with arguments that contract doctrine is an inadequate framework for determining the propriety of restraints on an employee’s post-employment activities. See, e.g., Closius & Schaffer, supra note [28] (advocating use of the “duty of loyalty” principle from agency law); but see Lycos Inc. v. Jackson, 18 Mass L. Rptr. 256, 258 (Mass. Super. 2004) (holding that failure to procure new restrictive covenant after material change in employment voided an earlier covenant).

No doubt the state supreme court was aware of an unpublished opinion in which an intermediate court of appeal had struggled with the question of whether continued at-will employment provided consideration for a signed covenant not to compete and had concluded that it would if the employer specifically conditioned continued employment on agreement and backed that up with a credible threat of discharge. However impractical such an approach might be from a human resources standpoint, the court of appeals’ explanation of modern contract doctrine and its logic was impeccable. Not only did the court acknowledge the power of the at-will employer to alter the terms of employment through its power to discharge and to induce assent to a contract by refraining from discharge, it also avoided blurring the line between consideration sufficient for contract formation with the substance of the exchange. What it did not perceive, or did not address, was the legitimacy of the employer’s interest. The facts give some reason to suspect, however, that the employer’s interest, however legitimate at its onset, was tainted by a desire to curtail employee flight to a better funded competitor. Farah was a well-paid executive and had signed the non-competition a month or two after receiving a promotion in rank and compensation. Although the non-compete recited consideration in the form of compensation and other benefits, the court concluded that the promotion and pay raise did not constitute consideration because of the lapse in time. Moreover, in contrast to some earlier Washington courts that had been reassured by the de facto provision of a substantive benefit after a technically flawed formation, see, e.g., Wood v. May, 438 P.2d 587 (Wash. 1968), this court was unimpressed that Farah had remained employed in an important position with access to information about Spacelabs’ products, customers and strategies for three more years of continued employment before he elected to quit and go to work for competitor Siemens. Spacelabs Medical, Inc. v. Farah, 94 Wash.App. 1039, 1999 WL 142424 (unpublished). Perhaps the court’s refusal to enforce the covenant was influenced by a suspicion that Spacelabs’ real motivation was to stem employee flight during a period of financial struggle. See Joel Ozretich, SpaceLabs makes modest progress on turnaround, PUGET SOUND BUS. J., 8 (Aug. 3 - 9, 2001).

107 Labriola, 100 P.3d at 794 (commenting that “[t]he general rule in Washington is that consideration exists if the Employee enters into a noncompete agreement when he or she is first hired.”).
Despite the seeming precision of this distinction, however, the court did not disapprove earlier cases in which the courts had overlooked some informality in the timing of consideration where employers had secured non-competition agreements from at-will employees after their hire and without promising or giving any new benefit. Responding to Pollard’s argument that these holdings did in fact demonstrate that Washington regarded continued employment or training as consideration for an at will employee’s promise not to compete, the court asserts that “[o]ur decision today…follows this court’s jurisprudence that independent consideration is required at the time promises are made for a noncompete agreement when employment has already commenced.” And then in the next sentence, the court confuses the issue again. “While continued employment and/or continued training may serve as sufficient consideration, it certainly was not the case here.” The court did not refer to any of the articles that had discussed this issue, or reflect any awareness that other common law jurisdictions had adopted a more nuanced approach.

109 Labriola, 100 P.3d at 793 – 796 (discussing, inter alia, Racine v. Bender, 252 P. 115 (Wash. 1927), in which a covenant signed after one week of employment and in each of 260 weeks thereafter was upheld; and Knight, Vale and Gregory v. McDaniel, 680 P.2d 448 (Wash. Ct. App. 1984), in which an agreement presented after hire but on the first day of work was upheld).

110 Labriola, 100 P.3d at 796.

111 See, e.g., Vanko, supra note [7] (collecting cases from around the country dealing with disputes over covenants after an employee has been involuntarily discharged); Susan E. Corisis, Post-employment Restrictive Covenants: Client Base Protection in Washington, Perry v. Moran, 109 Wash. 2d 691, 748 P.2d 224, 65 Wash. L. Rev. 209 (1990) (criticizing the state’s leading case on covenants protecting customer relations, in part, for court’s failure to investigate the legitimacy of the employer’s interest and the scope of the restriction); Leibman & Nathan, supra note [28] (recognizing that if employers develop legitimate needs to restrain particular employees after some period of employment, employees ought to have the power to bargain for compensation for such restraints, including the right to opt to retain at-will employment, and that failure of consideration ought not to be a basis for invalidating such agreements provided they are otherwise reasonable); Closius & Schaffer, supra note [28](arguing that former employee’s duty, if any, should be predicated on duty of loyalty, rather than contract.)

112 See, e.g., Collier Cobb & Associates, 300 S.E.2d 583, 586 (N.C. Ct. App. 1983) (refusing to enforce a covenant where ongoing, experienced employee acquired no new capacity to compete with employer and received no benefit other than continuing employment); Kadis v. Britt, 29 S.E.2d 543, 548 (N.C. 1944) (holding that covenant obtained through implicit threat to discontinue at-will employment failed for lack of consideration where employer’s business interest had not changed and salesman received no new benefit); contra Ins. Assoc. Corp. v. Hansen, 723 P.2d 190, 192 (Idaho Ct. App. 1986) (holding that threat of discharge for not agreeing covenant followed by eight of nine months of employment was sufficient consideration to uphold restraint on soliciting or servicing any customers of the employer); cf. Marine Contr. Co. v. Hurley, 310 N.E. 2d 915, 919 - 920 (Mass. 1974) (holding that covenant signed at end of
The court thus managed, remarkably, to preserve some ambiguity about whether at-will employment, standing alone, could provide consideration for a covenant not to compete. The concurring justice noted this, but even she failed to provide a logical reason for why forbearance to discharge an at-will employee in exchange for a covenant was any less sufficient consideration than an initial hiring at-will.

The confusion in the older state precedents was more semantic than doctrinal or substantive. With one exception, the older opinions did not distinguish particularly between the consideration that induced a bargain and the provision of an employment with characteristics that might justify a post-employment restraint. Their holdings are consistent with a focus on the latter – that is essentially whether the employer had a legitimate business interest. The older opinions did not reflect much concern about the timing of a formal consideration as an inducement for agreement, presumably because it seemed obvious enough that both hiring and retention are inducements to an at-will employee for accepting the employer’s terms and conditions. The ambiguity about continued employment arose because some of the earlier courts had been quite eager to enforce covenants where the employer had made or continued to make some arguable investment in the employee’s training or customer contacts -- despite the employer’s failure to secure agreement to a covenant before the employee started working. The relatively prompt formation of the covenants was significant, no doubt,

employment was enforceable where the employer had continuing legitimate interest to protect and former employee received consideration in form of advance payments from trust fund that were not yet owed).


See, e.g., Wood v. May, 438 P.2d 587 (Wash. 1968)(focusing on the adequacy of the consideration – training – for a covenant not to compete made about two months after initial hire.) This case is formally distinguishable in that the employer allegedly promised to teach the skill of horseshoeing in exchange for the covenant. In reality, however, as the dissent pointed out, the evidence showed that horseshoeing could be taught in a five-weeks’ course. As a result, the promise to train, coming two months after initial hire, may have been an empty recital of consideration, rather than a real inducement. If so, the court was not perturbed. It enforced the covenant, although it reduced its scope, because the employer had in fact provided training and, I suspect more importantly, had provided access to its customers for a two-year period. Cf. Schneller v. Hayes, 28 P.2d 273 (Wash. 1934) (invalidating a covenant signed about three weeks after the start of employment for failure of consideration where it did not promise continued employment or any other benefit.)
because the employee had had reasonable notice of the employer’s expectations and, at least theoretically, an opportunity not to agree by quitting. And so, I think the modern court interpreted the precedents exactly backwards. Rather than drawing a distinction between initial at-will employment and continuing at-will employment for purposes of supplying consideration, the earlier courts focused on whether the nature of the employment relationship, as a whole, and in retrospect, justified a restraint. They were artful in rejecting, or simply indifferent to, the employees’ arguments that a formal inducement for the covenant was missing.

Had the court focused on the interaction of the covenant with the caliber of Labriola’s employment relationship, it might have paused over using a failure of consideration as grounds for the judgment. The one precedent that did arguably focus on the caliber of the relationship was a depression-era case upon which Labriola and the supreme court relied heavily,115 -- indeed one merit of the opinion is its resurrection of this old case. In Schneller v. Hayes, the owner of an optical shop hired an optician who was apparently already trained. The employment was week-to-week at $30/week. Three weeks after starting work, the employee signed a covenant not to compete. Within four months, the employer reduced his pay and a few months later reduced it again, claiming insufficient business to support the agreed salary. The employment ended after the employee failed to persuade the employer to increase his pay. The employer sought an injunction to prevent the employee from setting up his own optical shop in the same small city.

At one level, Schneller resembles Labriola because the covenant not to compete was demanded after employment was ongoing (although only by a matter of weeks rather than years), and the employer reduced compensation after the agreement was purportedly formed. The state supreme court of the time conceived of the issues quite differently, however. It held that the employer had failed to provide a consideration for the covenant, but it did not even address the issue of whether continued employment could provide consideration for a signed covenant because, it said, the employee could have been fired.

had he refused to sign. Instead, the court focused on the employer’s failure to undertake any reciprocal obligation at all in exchange for the covenant. It then went on to carefully distinguish the consideration necessary to form a unilateral obligation from the undertaking of a substantive obligation which it thought necessary to equitable relief. Although it held the covenant void for lack of any consideration, it went on to explain that it would not have issued an injunction even if the employer had provided a consideration at the time of formation. The court explained that the employer had the right to terminate the employment at his pleasure and that, in such a circumstance, even if the covenant had been properly supported by a consideration at its onset, the employer’s lack of mutual obligation should preclude him from compelling any specific performance of the employee’s promise. The employer’s remedy for a breach would be damages, if any.\footnote{Schneller v. Hayes, 28 P.2d at 275.} If in 2004, the supreme court had followed the rationale of this old case, rather than a rather forced factual analogy about consideration, it might have articulated a principled basis for a declaratory judgment that Pollard could not enforce either the 2002 covenant or its 1997 covenants in equity, even if continued at-will employment were deemed consideration. At most Pollard might have had a claim for damages if Labriola had secured the job with ESP and had diverted customers through the use of information or personal relationships that Pollard had made possible.

One difficulty, of course, is that Pollard was not seeking an injunction and so the rationale in Schneller was not precisely transferable. Indeed, a possible explanation for the court’s seemingly strange evasion of the equitable issues may lie in the fairly unusual procedural posture. Recall that Labriola sued for a declaratory judgment that the covenant was unenforceable. Pollard answered on the merits. It did not seek to enjoin Labriola and could not have succeeded since, by the time of the litigation, it had frightened off his only prospective employer. Thus, although the court does not address the point, it is possible that it treated the case as one arising in law and not equity, thus
constraining a forthright decision for Labriola grounded on an equitable doctrine like unclean hands.\textsuperscript{117}

On the other hand, there does not appear to be any authority that would have precluded the court from considering the equitable issues raised by Pollard’s effort to reduce commissions (or increase workload). In general, declaratory judgment actions are neither equitable nor legal. Their character is dictated by the nature of the underlying claim.\textsuperscript{118} Washington’s rules of civil procedure provide that there shall be only one form of action for claims arising in law or equity,\textsuperscript{119} and I have found no Washington authority that would preclude the court from considering equitable issues even if the court did view this proceeding as mainly legal in nature because neither party sought injunctive relief.

Indeed, if the court were to refuse to consider equitable issues when an employee seeks a declaratory judgment, it would enable employers to set up a kind of trap for employees who want to free themselves of an invalid covenant. It permits the employer to benefit from whatever deterrence a covenant may give it with regard to the employee and to prospective employers, but to avoid censure for inequitable treatment of the employee so long as the employer does not seek injunctive relief. But this legal/equitable distinction would be irrelevant if a court adopted my proposal and evaluated the dispute in terms of Pollard’s legitimate interests. Then Pollard’s reason for altering the commission schedule and increasing its covenant’s scope could have been scrutinized in terms of those interests.

\textsuperscript{117} See, e.g., Custom Drapery Co., Inc. v. Hardwick, 531 S.W.2d 160, 166 (Tex. Civ. App. 1975) (refusing to enforce a covenant where the employer’s treatment of the employee had brought about a breach in the employment relationship that motivated the employee’s move to a competitor.)

\textsuperscript{118} See, e.g., Am. Jur. 2d \textit{Declaratory Judgments} §184 (1964): “The suit for declaratory judgment itself…is neither legal nor equitable; the nature of the case is determined by the underlying issue. The pleadings, relief sought, and the nature of the underlying case ordinary determine whether a declaratory judgment action is legal or equitable, but the court will review the case on appeal in the same manner in which the trial court considered it regardless of what the factors suggest. …Actions seeking a declaration of rights under a contract and a judgment awarding damages for breach of contract are essentially legal in nature.” (internal citations omitted).

Alternatively and at a minimum, the court could have ruled, as the concurring justice urged, that the 2002 covenant was more restrictive than necessary to protect any legitimate interest and it could then have considered whether a restraint on client solicitation would be reasonable, either pursuant to a judicial revision of the 2002 covenant if the court chose to deem that covenant properly formed or pursuant to the earlier 1997 covenant if it did not.

If the court had selected that last approach, the court should probably have remanded the case to the trial court for further findings of fact relevant to the legitimacy of Pollard’s interest and to the reasonableness of the restraints. There is no information, for example, about whether custom print businesses compete for repeat customers based on knowledge of their requirements or whether competition is based largely on price. That information was necessary to make a reasoned decision about whether Labriola’s exit with customer information could pose a competitive threat to Pollard sufficient to justify any restraint.120

In sum, the state supreme court might have used this case to establish a more constructive precedent for employers and employees. As it is, they will, inevitably, deal with this kind of dispute again. The court could have decided to exercise its discretion to somewhat reduce the procedural advantages of an employer at-will and reduce its leverage in situations like this where the employer wants or needs to alter the terms of employment. It would not have muddled the doctrines of consideration or of employment at will by treating the latter as consideration at one moment and not at another during an employment at will. It would have preserved the at–will employer’s power to alter the

120 See, e.g., Cypress Group Inc. v. Stride and Assoc., 17 Mass. L. Rptr 436 (Mass. Super. 2004) (holding that employer had no legitimate interest in restraining employees where their jobs involved “cold-calling” customers); cf. Outsource Int’l, Inc. v. Barton, 192 F.3d 662, 668 (7th Cir. 1999) (holding that covenant was enforceable under Illinois law where covenant properly barred ex-employee from contacting customers with whom he would have had no contact “but for” former employment). Judge Posner dissented, arguing that the customers’ business depended mostly on price and that the relationships did not meet Illinois law’s requirement that a restrictive covenant could only protect an employer’s “near permanent” relationships. The dissent is interesting because Judge Posner manages to simultaneously disapprove of such “hostility” to contractual restraints on the ground that a competent employee’s assent to the covenant in exchange for a job should be sufficient for enforcement, id. at 669–70, while at the same time dissenting and arguing that the majority should not have enforced the covenant in this case due to the state law. Id. at 671–674. I think Judge Posner’s opinion reflects a understandable ambivalence about covenants not to compete in the mind of a simultaneous proponent of free markets and a scholar of antitrust law.
terms of employment but perhaps limited the remedies an employer may recover for breach of a restrictive covenant where the employer has not provided the employee with a corresponding commitment. It would not have invited employers to construct covenant transactions with technical consideration where they want or need to secure covenants from ongoing employees. Instead, it would have encouraged them to reciprocate with some enforceable commitment to the employee – which might include a promise not to decrease compensation. In short, Washington’s court of last resort missed an opportunity to articulate sounder, fairer bases for enforcing covenants.

The explanations for a decision of this caliber are probably multiple: a poorly reasoned trial court judgment; a relatively thin group of precedents, some of which were not very well-reasoned, that invited counsel to develop theories of their respective cases turning on consideration; a legal culture imbued with a strong presumption in favor of employment at-will; and an elected judiciary perhaps hesitant to issue decisions that might generate opposition in the business community – a community better organized and deeper pocketed than employees at-will.

If this case were an isolated one, or the problem it failed to address trivial, then it might be safe to ignore it. Other courts have faced and continued to face similar problems, however. Moreover, there does not appear to be any consensus about whether a

121 In making this recommendation, I do not minimize the importance of assuring that the employee at-will is not effectively coerced into assenting to the covenant. An initial job offer is probably easier to pass up than a discharge to accept. See, e.g., Arnow-Richman/Dilution supra note [11] (noting the deleterious effect on an at-will employee’s effective power to exit if a covenant not to compete is presented until after the employment has commenced.)

122 Professor Alan Hyde, among others, has made a similar point in discussing the proper degree of enforcement of restrictive covenants and trade secrets: “So, what all this does to me is reinforce the cautious legal conclusions from my book. The data is better than I had at the time of the book. At the very least, any suit against a departing employee should be evaluated against what the employer promised. If the employer promised a lifetime job, then the employer has a right to demand more loyalty than the employer who didn’t promise anything.” Symposium, supra note 30.

diminution in the quality of an employment should affect enforcement of a covenant – whether or not it is supported by sufficient legal consideration. In the remainder of this part, I briefly summarize and compare rationales from several recent cases from other jurisdictions. They vary. My point here is not recommend any one of the approaches but to illustrate that courts less wedded to contract formation doctrine are more frank in their analyses of the facts and the equities and thus write better opinions.

In a recent case that bears the nearest factual resemblance to Labriola, the Montana Supreme Court similarly held that a non-disclosure agreement and covenant not to compete were unenforceable for failure of consideration when they were signed by an at-will employee after four months of employment and one month after a promotion.\footnote{Access Organics, Inc. v. Hernandez, 175 P.3d 899 (Mt. 2008).} Shortly after the covenant was signed, the employer “experienced financial difficulties and laid off” several employees, including the employee. The employee voluntarily returned to work part-time after a short interval, but resigned shortly thereafter. He and another former employee then formed a competing business in the same area. The trial court held the agreements were enforceable and granted a preliminary injunction.

In response to the employee’s appeal, the Montana court acknowledged Labriola v. Pollard, but was more precise in its rationale than the Washington court had been.\footnote{Id. at 904 (quoting Labriola and commenting that “[w]e decline to broadly hold that continued employment may never serve as sufficient consideration.”)} First, it evaluated whether the agreement and covenant protected legitimate interests, and found that they did.\footnote{Id. at 902 – 903. In Montana, regulation of restraints on competition proceed from a statute which prohibits “[a]ny contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind.” Mont. Code Ann. § 28-2-703 (2007). A recent decision suggests that Montana courts are less likely to find covenants reasonable than Washington courts are. See Mont. Mountain Prod. v. Curl, 112 P.3d 979, 982 (Mont. 2005) (refusing to enforce a post-employment restraint on competition with a 250 mile radius because it precluded the employee from practicing her profession “in the vicinity of where she lives.”) No doubt the fact that Montana is sparsely populated with few major urban centers often means that a geographical restraint, even one much more modest than 250 miles, would force an employee to move from the vicinity of her home, and the state’s particular demographics, combined with the wording of the state’s statute, may contribute to the court’s less tolerant attitude toward employee covenants. For the Montana statute, see supra note 16.} Then, it explained that it would not necessarily enforce covenants secured from an ongoing at-will employee because such an employee is “vulnerable to
heavy economic pressure to sign the agreement in order to keep his job.” Instead, it would require “good consideration” such as increased job security or extended term of employment.127

To the extent that the court began with the employer’s interests and acknowledged the economic and psychological reasons for differentiating consideration in the form of an initial at-will hire from continuing at-will employment, the opinion’s rationale is more persuasive than that in Labriola. Nevertheless, like the Washington court, the Montana court’s rationale did not expressly address the effect of the employer’s financial difficulties, employee lay-offs, or the defendant/appellant’s reduced hours before he resigned, however one might suspect that these facts bore on the court’s decision that there was a failure of consideration. Notably, the court ignored the fact that the employee had been promoted a month before and might perhaps have acquired new responsibilities that might have constituted legal consideration and warranted a covenant. I suspect, however, that the court preferred to relieve the employee from his facial obligations to a struggling business.

No doubt, one reason for the judicial silence about the employer’s financial issues, in Montana as in Washington, was the very fact that the employee was at –will. Neither court may have wished to adopt a rationale that could interfere with an at-will employer’s prerogatives to discharge or to reduce the employee’s hours.128 On the other hand, since this was an action in equity, the court could have exercised its discretion to refuse to issue the injunction on the ground that the former employer’s inability to provide full-time employment coupled with its insistence upon the covenant was unreasonable in the circumstances. Of course, that might have required a remand for factual evidence into whether the employer was a viable business and whether the former employee’s

127 Access Organics, 175 P.2d at 904.

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competition made unfair use of information, training or customer contacts that he had developed during the employment.

In a case that may reflect a somewhat similar scenario in which one firm succumbs to competition from another, a Colorado court of appeals recently refused to enforce a one-year covenant not to compete against an employee at-will who signed it two years after starting work.\textsuperscript{129} The employee resigned about a year later and went to work for a competitor three after that. The employee was the only employee who had significant customer contacts in the region and the former employer alleged that its own decision to discontinue business in that region was a direct result of the employee’s decision to leave and to the competition posed by the other company.\textsuperscript{130} (The appellate opinion does not evaluate the reasons for the failure of the first employer’s business in the region, and so it is not clear whether the employee switched jobs opportunistically to pursue an advantage or whether he departed because he understood that the former employer’s business was in trouble.) In any event, the court concluded that the covenant was unenforceable for failure of consideration, citing among other authorities, \textit{Labriola},\textsuperscript{131} for the proposition that continued employment alone was not consideration.

This case provides a counterpoint to \textit{Labriola} in some respects. If we can assume that the quality of Horner’s employment had not diminished and was not threatened by the potential demise of the Lucht’s operations in the region before Horner resigned, then it would seem that the employer may actually have had a significant and legitimate business interest in preventing this particular employee from competing by diverting customers to the competitor. The legitimacy of Lucht’s business interest should have been the first question, and had such an interest been established, then perhaps the agreement should have been enforceable unless there was evidence that Horner had had no practical alternative to signing or that Lucht’s business was likely to fail anyway, and

\textsuperscript{130} Id. at *1. The opinion may imply that the employer knew when it hired employee Horner that he had, or would have, the only significant customer contacts in the region. If so, one might infer that the employer, LCP, was remiss in failing to obtain a non-compete or non-solicitation agreement upon initial hire.
\textsuperscript{131} Id. at *3.
Horner had simply jumped before the ax fell, as it were. The technical failure of consideration ought not necessarily to have been determinative.

My point is not that employers should have license to extract concessions during from an ongoing at-will employee; they should not. However, it is possible that conditions changed, that the employee developed customers that the business had not had and, possibly, that a new, and possibly unforeseen, competitor threatened to move into the business precisely because the first company had done the groundwork. In such a case, the employer may develop a legitimate interest that might warrant a covenant. That a formal consideration, a small pay increase for example or an increase in responsibilities, would convert the same covenant from unenforceable to enforceable seems symbolic, rather than psychologically or economically material. Moreover, even if the employee had signed the covenant as a condition for initial hire, it still ought to be relevant if his reasons for jumping to the competitor were opportunistic or motivated by concern over the former employer’s viability. The presence of undoubted consideration ought not to negate that issue.

In contrast to this focus on consideration, New York and Massachusetts have older cases with holdings that expressly acknowledged the potentially adverse effects of strict enforcement of a covenant without regard to a deteriorating or terminated employment. New York has traditionally required some minimal mutuality of obligation for enforcement of a covenant, even where the employee has no right to continued employment. For example, where employees, subject to covenants not to compete, were terminated without cause but not wrongfully, the court held that the covenants were not enforceable because a willingness to employ on reasonably comparable terms was a condition to the employer’s rights to enforce. 132

Massachusetts has a blanket rule that any material alteration (up or down) in the employment abrogates an existing covenant. An employer must negotiate, or at least provide some fresh consideration for, a new one. One might, at a stretch, read into two recent Massachusetts cases a view that the employer must not only be willing to employ but to maintain employment upon reasonably competitive terms in order to enforce a covenant against an employee who quits. In such cases the courts expressed skepticism that the employer had any legitimate business interest and a suspicion that the employers were motivated instead by a desire to retain the services of a valuable employee without being willing to provide compensation or other benefits sufficient to do so. In Exeter Group, Inc. v. Sivan, the court refused to enforce a covenant not to compete against a software engineer who left to work for Oracle, a competitor. In the new job, the engineer would use the same software that she had used in the old job, but the court was persuaded that she had taught herself rather than been trained. The employee, an immigrant working under an H-1B visa, claimed that her motive for leaving Exeter was that Oracle agreed to sponsor her for a green card. Exeter agreed to sponsor her application and offered her another job about three weeks after she had left. That seemed, perhaps, only to indicate Exeter’s indifference to her alleged competition and its desire to retain her services.

\[133\] E.g., Cypress Group Inc. v. Stride & Assoc., 17 Mass. L. Rptr. 436 (Mass. Super. 2004); Lycos Inc. v. Jackson, 18 Mass. L. Rptr. 256 (Mass. Super. 2004). See also Econ. Grocery Stores Corp. v. McMenamy, 195 N.E. 747, 748 (Mass. 1935) (refusing to enforce a covenant and enjoin competition by an employee who had built up a meat department and then was arbitrarily fired, commenting “there was no definite term of employment but there was employment under the contract for about fifteen months. The contract might have been terminated at the will of either party. An employer may act so arbitrarily and unreasonably in exercising his right of termination that a court of equity will refuse aid in enforcing for his benefit other parts of the contract. … A suit in equity like the present, to enforce a negative covenant made by the defendant, is in reality a petition for specific performance. … Specific performance is not a matter of strict and absolute right. A petition of that nature is addressed to the sound discretion of the court. It will not be granted if the conduct of the plaintiff is savored with injustice touching the transaction, even though there is no sufficient ground for the rescission of the contract.” (internal citation omitted)). Like Schneller, 28 P.2d 273 (Wash. 1934), McMenamy is a depression-era case. The Massachusetts court makes express reference to the effect of the depression and the employee’s likely unemployment as a factor weighing against enforcement, 195 N.E. at 749). Massachusetts provides another example of a jurisdiction whose seminal precedent’s rhetoric exerts a salutary effect on subsequent case law development. See supra note 69.

\[134\] 2005 WL 1477735 (Mass. Super.)

\[135\] Id. at *3.

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In Kauzens v. Diamond Diagnostics, Inc., the court took no action on an employee’s claim for a preliminary injunction to bar enforcement of his covenant, expressing doubt that the employer would attempt to enforce the covenant. (The succeeding dicta would certain deter a rational employer from such an attempt.) Kauzens had been employed and trained to refurbish used medical equipment. He became dissatisfied with his work and accepted a position with a seller of new medical equipment. The court thought invasion of the employer’s interests unlikely given the difference in the businesses and the employee’s work, but it also commented: “[t]he real concerns of Diamond seem not so much Kauzens working for [the competitor] than with his leaving Diamond. Diamond speaks glowingly of Kauzens’ skills and of his importance to Diamond’s refurbishing work. But, despite this concern, Kauzens was left as an employee at will with no job security whatsoever, and was far from being compensated at executive or senior technical employee level wages.”

In general, where an employee has some contractual employment rights, courts seem to be more willing to condition enforcement of the covenant upon good faith performance of whatever obligations the employment contract contains. A careful employer may be able to draft each document, however, so that the covenant remains in force even if the employer breaches the employment contract. If, in contrast, the employment contract and covenant are part of one agreement or the court treats them as arising from one transaction, a court may find breach of the employment contract excuses the employee’s duty under the covenant. For example, where an employer unilaterally altered a sales employee’s commission structure so that a greater risk of customer non-payment fell on

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137 Id. at *5.
138 For a useful summary and reference to recent cases involving the effect upon a post-employment restraint of a breach of a statutory or contractual duty to an employee, see Callman, supra note [6]; see also Restrictive Clause in Employment or Sales Contract to Prevent Future Competition or Performance of Services for Others as Affected By Breach By Party Seeking to Enforce It, of His Own Obligations Under the Contract, 155 A.L.R. 652 (1945).
139 See, e.g., Coates v. Bastian Bros. Inc., 741 N.W.2d 539 (Mich. Ct. App. 2007) (holding that covenant remained in force where covenant document specifically states it will remain in force regardless of breach of separate employment contract.)
the employee and the employee received about $24,000 less in commissions than he would have received under the original structure, a Missouri court of appeals held that the employer had breached the employment agreement materially and was not entitled to an injunction to enforce a covenant not to compete.\(^\text{140}\) This case is, of course, distinguishable from Labriola’s in that there was no dispute that the employee had an employment contract that specified a commission structure. Nevertheless, the court’s finding that the changes to the commission structure were material breaches was not inevitable -- the employee had continued to work after the changes for a period of nine or ten months, although he did voice objections to the changes. In that case, the court found that the employer was barred from equitable relief in part based on the doctrine of unclean hands because it had confronted the employee with a “Hobson’s choice of quitting his job or accepting the [changes] unilaterally imposed by [the employer].”\(^\text{141}\)

A recent Ohio court was willing to interpret a vaguely worded contract to construct a contractual obligation to otherwise at-will employees where the contract stated that commissions would be paid at a rate to be “mutually agreed.” The employees quit a few months after the commission rate was reduced, after having objected to the reduction, and took jobs barred by the covenant. Finding that the employees had not agreed to a reduction in commissions, the court then held that the breach of the compensation contract rendered the covenant not to compete unenforceable.\(^\text{142}\)

A final example from the California Supreme Court in 2008 involves a different effort by an employer to use the leverage afforded by a covenant.\(^\text{143}\) Upon the breakup of the accounting firm Arthur Andersen in the wake of the Enron scandal, Andersen sold a tax practice group located in Los Angeles to HSBC. The plaintiff Edwards had been an employee member of the group. He had signed a covenant not to compete with

\(^{140}\) Supermarket Merch. & Supply, Inc. v. Marschuetz, 196 S.W.3d 581 (Mo. Ct. App. 2006); \textit{but see} Alliance Metals Inc. v. Hinley, 222 F.3d 885 (11th Cir. 2000) (holding that constructive discharge of contract employee did not necessarily void covenant under Florida law); Kupscznk v. Blasters, Inc., 647 So. 2d 888, 891 (Fla. Dist. Ct. App. 1994) (holding that reduction in commissions for long-term vice president of company without formal employment contract did not void covenant).

\(^{141}\) Supermarket Merch. & Supply, 196 S.W. 3d at 586.

\(^{142}\) Brakefire Inc. v. Overbeck, 878 N.E.2d 84 (Oh. Com. Pl. 2007).


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Andersen. As a condition for employment by HSBC he was required to sign a “Termination of Non-compete Agreement” or “TONC.” The TONC purported to release him from the provisions of the non-compete so that he could work for HSBC, but it also purported to release Andersen from claims that Edwards might have against it. Edwards, concerned about potential liability in the wake of the scandal, refused to sign and so was not hired by HSBC. Edwards sued for tortious interference with a business prospect.

The preliminary issue was whether Andersen’s demand for the TONC was proper. The California Supreme Court reaffirmed the state’s statutory ban on employee covenants not to compete, and rejected the defendant’s argument that California had adopted a narrow exception to the ban. The court then held that it was wrongful for Andersen to demand that Edwards sign the TONC as consideration for the release from the invalid covenant just as it would be wrongful under California law to condition continued employment upon agreement to an unenforceable covenant not to compete. The court held, in part, that by doing so Andersen might have interfered with Edward’s prospective economic advantage and remanded the case to the trial court for further proceedings.

A state court of last resort that does not now have criteria for dealing with the leverage afforded by the combination of at-will employment and a covenant might consider adopting the Massachusetts rule that a material change in employment warrants a new covenant and that the employee has the right to refuse to sign and is not bound by the previous covenant, if any. It also might consider an extension of California’s rule that it is wrongful for an employer to condition employment or continued employment upon assent to a covenant that proves to be invalid under that state’s law. In addition, if the employee were then denied a job with another firm because of such a covenant, the employer would be liable for interference with a prospective advantage. This might help

145 Edwards v. Arthur Andersen LLP, 189 P.3d at 290 – 293.
146 Id. at 294 (citing D’sa v. Playhut, Inc., 85 Cal. App.4th 927, 929, 102 Cal. Rptr.2d 495 (2000) for the proposition that “[a]n employer ‘cannot lawfully make the signing of an employment agreements, which contains an unenforceable covenant not to compete, a condition of continued employment …[A]n employer’s termination of an employee who refused to sign such an agreement constitutes a wrongful termination in violation of public policy.’”)

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curb improper leverage against employees at-will by exposing employer’s to some liability where the covenant restrictions are unnecessary or excessive.

Conclusion

In this article, I have argued that employers may gain unwarranted leverage over employees at-will through the combination of their powers to alter or terminate an employment and the procedural advantages that accrue to them in many states from being able to characterize their efforts to prevent various types of alleged unfair competition as claims for breach of contract. I have argued that courts confronted with controversies in which such leverage may be operating should be vigilant to deprive the employer of its procedural advantage by denying a presumption of validity to a covenant not to compete simply because its formation conformed with the conventional elements of contract formation. I have also suggested that courts should not succumb to the corollary of invalidating covenants based on technical contract formation doctrines without examining the facts about the employer’s interests, the negotiation between the parties, the employment relationship, and the employer’s access to alternative remedies for any injury. By focusing on contract formation, state appellate courts may give relief to individual employees now and then when an employer slips up and fails to construct consideration, but they perpetuate the doctrinal framework that gives the employers an often unwarranted procedural advantage.

My four factor proposal does not abandon contract enforcement for covenants. It simply tends to limits contract law’s force to the negotiated covenant.

I have also included some suggestions about the rhetorical responsibilities of state appellate courts. To that end, I subjected one opinion to a sustained critique in an effort not only to show why the opinion was misguided, but also to show why a court might have written such an opinion. Legal academic scholarship has been faulted for being not
useful to courts. By showing how various inputs – a state’s precedents, counsel’s strategies and skills, the pressure of crowded dockets -- might tend to produce a suboptimal opinion from an economic, doctrinal and rhetorical standpoint, I hope this article helps advocates adopt better theories of their cases and construct better trial strategies and appellate arguments. I hope trial and appellate courts respond in kind.

I am not sure that the legal doctrines or the values are as controverted as they seems. The most extreme positions are, perhaps, just defensive litigation postures – after disputes have reached a point of no compromise. Perhaps lawyers and judges could reach some higher ground.