

Charleston School of Law

From the SelectedWorks of Kevin Eberle

November, 2008


Eroding Disfavor of Non-competes and the Inevitable Disclosure Doctrine in South Carolina

Kevin R. Eberle, *Charleston School of Law*



SELECTEDWORKS™

Available at: http://works.bepress.com/kevin_eberle/6/



Eroding Disfavor of Non-competes and the Inevitable Disclosure Doctrine in South Carolina

By Kevin R. Eberle

Agreements that limit the ability of the public to enjoy the services of a provider have been begrudgingly tolerated in South Carolina when they can withstand a very strict review. During the last several years, however, there has been a slight movement towards enforcement. South Carolina courts have, for instance, limited the types of contract terms to which strict review is applied in the first place.

The next step towards a pro-employer position might well come when South Carolina courts confront the doctrine of inevitable disclosure. If adopted in South Carolina, the theory would permit employers to enforce a sort of judicially created non-compete agreement. Employers would be able to prevent workers from competing while avoiding many of the traps that invalidate many non-compete agreements. Indeed, employers might make a case against competition even in the absence of any contractual term at all.

The turning tide in South Carolina

The first South Carolina case that addressed the test for non-compete agree-

ments was *Carroll v. Giles*, 30 S.C. 412, 9 S.E. 422 (1889). The plaintiff, Carroll, and defendant barber, Giles, agreed that Carroll would supply a barbershop at which the barber would work. The barber agreed in writing: "[I]n consideration of the shop being furnished for his use, he binds himself, and hereby agrees not to do any work, *now or hereafter*, outside of the shop owned by H.W. Carroll, or hire to any party or parties, or open a shop of any kind to carry on the barber business, either directly or indirectly, in Bennettsville, S.C. He hereby agrees to convey all patronage extended to him heretofore to the business owned by H.W. Carroll." *Id.* at 422 (emphasis added). When the barber quit, the shop owner sued for an injunction and for damages. The barber contended the term was supposed to last only as long as the business relationship lasted; an indefinite term would create a monopoly in the town in violation of public policy. The court recognized the following test: "[Contracts in partial restraint of trade] must be partial with respect to the territory included; reasonable with respect to the amount of territory, the circumstances and

rights of the party burdened, and the one benefited by the restriction, and the number and interests of the public, whose freedom of trading is circumscribed; and made upon a valuable and sufficient consideration." *Id.* at 423.

Since that first discussion, South Carolina has, in scores of cases, expressed its reluctant willingness to enforce non-compete agreements only when reasonable. See *Moser v. Gosnell*, 334 S.C. 425, 430, 513 S.E.2d 123, 125 (Ct. App. 1999) ("Generally, covenants not to compete are looked upon with disfavor, examined critically, and strictly construed."). In a series of cases, the S.C. Court of Appeals and the S.C. Supreme Court have interpreted various prongs of the test and teased out meanings and limitations that have limited the possible reach of non-competes. See, e.g., *Stonard, Inc. v. Carolina Flooring Specialists*, 366 S.C. 156, 621 S.E.2d 352 (2005) (recognizing availability but declining to use the blue-pencil rule on the facts of the particular case); *Rental Uniform Serv. of Florence, Inc. v. Dudley*, 278 S.C. 674, 301 S.E.2d 142 (1983) (holding that mere continuation of existing employment is not sufficient consideration to support a non-compete agreement).

The next step

One of the more interesting doctrines to develop in the field of restraints on competition during the last several years is the doctrine of inevitable disclosure. Inevitable disclosure is an outgrowth of the Uniform Trade Secrets Act that allows "threatened" misappropriation to be enjoined and not just actual misappropriation. A court can issue an injunction to prevent an employee from working for a competitor of his former employer even where there is neither a non-competition agreement nor any proof of actual or threatened misappropriation; employers need only demonstrate a real and present danger of disclosure for an injunction to issue. See *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1263-4 (7th Cir. 1995). The doctrine allows courts to prohibit an employee from working for a com-

petitor of the former employer if the employee could not help but use or disclose the former employer's trade secrets in carrying out her new job. Most courts require that the former employer show the following: (1) trade secrets exist, (2) the employee had access to them and (3) the trade secrets would be inevitably used.

PepsiCo is a leading case on inevitable disclosure. In that case, a general manager of Pepsi accepted a job in Quaker's sports drink division to execute its sports drink marketing plans. The defendant had worked at Pepsi for 10 years and had had access to Pepsi's confidential plans for increasing its market share in sports drinks. The danger of misappropriation in *PepsiCo* was not that Quaker threatened to use PepsiCo's secrets to create marketing or distribution systems based on PepsiCo's ideas, but rather that Quaker would be able to use PepsiCo's plans to anticipate its distribution and marketing strategies, giving Quaker an unfair advantage. The court said that Pepsi found itself "in the position of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game." Therefore, the court applied the Illinois Trade Secrets Act that provides that "[a] plaintiff may prove a claim of trade secret misappropriation by demonstrating that the defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets." The court thereby prevented the manager from taking the Quaker job for six months on the grounds that the proposed employment would inevitably lead the manager to disclose trade secrets of his former employer and make decisions for his new employer based on those trade secrets.

Since the Seventh Circuit's opinion, there have been other cases of employers seeking to enjoin their employees from even taking jobs that might lead to misappropriation. Those cases have shown that courts have a reluctance to apply the doctrine literally and instead look for some sort of additional factor before granting an injunction. Despite the name of the doctrine, no court has been willing to apply the doctrine absent at least *some* evidence that

some sort of use of the confidential information was likely. See, *Xantrex Tech. Inc. v. Advanced Energy Indus., Inc.*, 2008 WL 2185882 (D. Colo. May 23, 2008).

Even in the original case recognizing the doctrine, the court indicated that it was not worried about "inevitable" disclosure, but rather what might have been described as "very probable" disclosure. In *PepsiCo*, the worker had been unclear in his testimony about his new responsibilities at competitor Quaker. He had also not been perfectly candid with his former employer about his new job with Quaker. It was those facts of his particular case that prompted the court to approve the injunction, not a belief that disclosure was truly inevitable. The court even noted that "Redmond's assurances to PepsiCo [were less] than comforting." *PepsiCo*, 54 F.3d at 1267. The court did not use a pure inevitable disclosure theory; rather it looked for indications that trade secret misappropriation would occur and based its decision on those indications.

Other courts have likewise been unwilling to find that mere knowledge itself would invariably lead to disclosure. One Michigan court showed typical judicial skepticism of giving the inevitable disclosure doctrine its literal meaning. In *CMI International, Inc. v. Internet International Corp.*, a Michigan appellate court considered *PepsiCo* under Michigan's version of the Trade Secrets Act and concluded that "for a party to make a claim of threatened misappropriation, whether under a theory of inevitable disclosure or otherwise, the party must establish more than the existence of generalized trade secrets and a competitor's employment of the party's former employee who has knowledge of trade secrets." 649 N.W.2d 808, 813 (2002) (suggesting the need for evidence of duplicity beyond simply employment by a competitor). Thus, the employer without a non-compete agreement should be prepared to offer evidence such as position similarity, competition between

current and former employers, and willingness of the employee to disclose, tending to show that misappropriation of trade secrets is more than simply "inevitable."

Often, the plaintiffs will rely on evidence of more than mere possible use of trade secrets. In *Merck & Co. Inc. v. Lyon*, for example, the District Court for the Middle District of North Carolina held that, under the inevitable disclosure doctrine, "a plaintiff may prove a claim of trade secret misappropriation by demonstrating that [the] defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets." 941 F. Supp. 1443, 1457 (M.D.N.C. 1996). In that case, Lyon was working on the product Pepcid AC as part of a joint venture between Merck & Co. Inc. and Johnson & Johnson. Lyon's new employment was with Glaxo Wellcome, a company that produces Zantac 75. With Glaxo Wellcome, Lyon was to be involved in planning and discussing head-to-head advertising between the two drugs. The trial court granted an injunction against his taking the new job. The *Merck & Co.* court qualified its decision by stating that, "courts are reluctant to grant an injunction that will prevent a person from earning a livelihood." *Id.* at 1458. The court further noted that to support a broad injunction preventing competitive employment altogether, North Carolina courts would "require a showing of bad faith, or underhanded dealing, and that the competitor lacked comparable levels of knowledge and achievement," *id.* at 1459, while more narrowly tailored relief might be had based on "the degree of similarity between the employee's former and current position, and the value of the information," *id.* at 1460.

Applying those principles to the facts at hand, the court found it significant that, when originally asked by Merck & Co. whether he was going to a competitor, Lyon responded "that he was considering a couple of opportunities outside the pharmaceutical field." When posed with the same question a few weeks later, Lyon's response was the same. It

appears Lyon lied to Merck & Co. because he was attempting to secure a large benefits package that he would not have been eligible to receive had he resigned and gone to work for a competitor. Thus, the court fashioned a narrowly tailored injunction that did not prevent Lyon from working for Glaxo Wellcome entirely; it simply prevented Lyon from working on certain aspects of a single product for one to two years.

Likewise, in *DoubleClick, Inc. v. Henderson*, the court granted an injunction under inevitable disclosure where two former employees' new job functions would "inevitably" lead them to rely on trade secrets belonging to the former employer. 1997 WL 731413 (N.Y. Sup. Ct. 1997). One of the defendants had not signed a non-compete agreement. DoubleClick sold Internet ads. After becoming dissatisfied with the way DoubleClick operated, the defendants, Dickey and Henderson, agreed to open their own company called Alliance Interactive Network. There was no question that the employees had access to confidential information belonging to DoubleClick. In enjoining the defendants, the court reasoned that the defendants would be unable to remove DoubleClick's trade secrets from their minds. Even more importantly, the defendants had already used some of DoubleClick's trade secrets and appeared willing to do so again. The court noted that a document found on Henderson's computer contained a discussion of DoubleClick's margin. His computer also contained a proposed plan for telling DoubleClick's largest client that the company's margin was too high, indicating that the defendants had "at least contemplated using such information to compete against their former employer." *Id.* at 5. The resulting injunction prohibited the defendants from starting any company or accepting employment with any DoubleClick competitor for six months. Again, the court relied on more than simple "inevitable" disclosure theory in deciding the case; it used threatened misappropriation to grant an injunction preventing

the defendants from competing with DoubleClick for a given period of time.

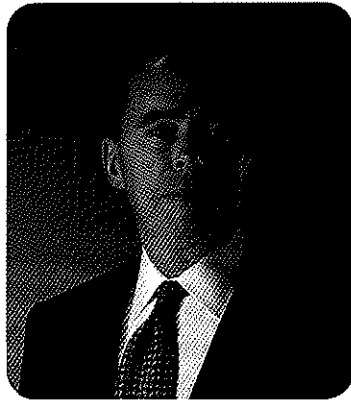
Even assuming that courts would expect some evidence of likely disclosure, employees have another reason to worry about the doctrine—the practical effect of inevitable disclosure is a judicially created non-compete agreement for which no compensation was negotiated. Whereas the courts have traditionally been loathe to pare down an overbroad contract to an enforceable size, the doctrine of inevitable disclosure can result in courts' starting from nothing and writing entire contracts for parties. For example, in *PepsiCo* there had been no expression of any limits on the worker's ability to secure employment later, as long as he did not disclose confidential information, and he had received no consideration for such a restraint. Nevertheless, the court's injunction barred him from taking a competing job for a period of six months. In other words, the court essentially wrote not just a specific term for the parties without their consent, but an entire non-compete agreement.

It appears, as some small solace to employees, that the courts will at least apply a quasi-non-compete reasonableness analysis in crafting the scope of the implied non-compete term. For example, the courts will not conclude that the risk of disclosure—and resulting judicial restraint—continues beyond a reasonable amount of time. For instance, the more rapid the technology at issue evolves, the less willing a court is to apply the doctrine after a passage of time. See *Lexis-Nexis v. Beer*, 41 F. Supp. 2d 950, 958 (D. Minn. 1999). On the other hand, if the secrets concern a field in which development is slower, such as accounting or the law, then the inevitable disclosure doctrine is more likely to be applied to prevent an employee from competing. *Bridgestone/Firestone, Inc. v. Lockhart*, 5 F. Supp. 2d 667, 682 (S.D. Ind. 1998).

Conclusion

Traditionally, employers in South Carolina have faced an uphill

When a case turns on forensic accounting and business valuation, attorneys turn to George DuRant.



George DuRant, CPA, ABV, ASA, is a frequent expert witness in commercial litigation involving accounting principles, business valuation, damages, ethics and insolvency. A past chairman of the Business Valuation and Litigation

Services Committee of the South Carolina Association of CPAs, he is the author of articles published in *South Carolina Lawyer*, *The CPA Report* and other professional journals.

Representative List of Attorneys Served

Bob Anderson • Keith Babcock • Desa Ballard • Alex Beard
George Cauthen • Blaney Coskrey • Dick Harpootlian • Cam Lewis
Mary Lewis • Frankie Marion • Henry McKellar • Tom Pope
Mike Quinn • Biff Sowell • Harry Swaggart • Gene Trotter

George DuRant on Mike Quinn:

Over the past twenty years, Mike has retained me on accounting malpractice, breach of fiduciary duty and accounting/valuation cases. For a personal reference on this work, please contact Mike at the Quinn Law Firm, 803.779.6365 or mhqsr@bellsouth.net.



GEORGE DURANT, LLC

P.O. Box 2746 • Columbia, SC 29202 • 803.212.8974
george@gdurant.com

battle in crafting and enforcing restrictions against their employees' attempts to compete. Many employers have probably written off the possibility of enforcing non-compete agreements, especially those that are not artfully drafted. See Philip Kilgore & Jeff Dunlaevy, *Battle-Worthy Non-Competes: Lessons from the Wreckage of Recent Cases*, S.C. LAWYER, May 2008, at 24, 29 ("The development of the common law applicable to non-compete clauses has left in its wake numerous employers who reasonably thought themselves protected."). Still other employers might have abandoned any effort at a non-compete agreement, perhaps in an undisclosed exchange for lower compensation to the employee.

Today, though, employers are well-advised to rethink their options. The law of South Carolina is positioned just like the law in other jurisdictions that have endorsed the doctrine of inevitable disclosure. The South Carolina Trade Secrets Act, South Carolina's slightly expanded version of the Uniform Trade Secrets Act, was adopted in 1997. 1997 S.C. Acts 200-08. Most important for purposes of the inevitable disclosure doctrine, South Carolina's own version of the statute retains the critical language "Actual or threatened misappropriation may be enjoined." S.C. CODE ANN. sec. 39-8-50 (Supp. 2007) (emphasis added). Those three words potentially open the door to use of the inevitable disclosure doctrine in South Carolina.

When given the chance, employers in South Carolina should begin pushing for acceptance of the doctrine in South Carolina. Doing so would suddenly create the chance for engrafting a sort of implied non-compete agreement onto old contracts whose terms either might not withstand strict scrutiny or might never have contained a non-compete term at all.

Prior to joining the faculty at the Charleston School of Law, Kevin Eberle was frequently involved in non-competition cases as an attorney with Rosen, Rosen & Hagood, LLC.