

*Void Agreements, Knocked-out Terms, and Blue Pencils: Judicial and Legislative  
Handling of Unreasonable Terms in Noncompete Agreements*

By

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## **I. Introduction**

It's a common scenario, played out numerous times every business day:

*Sam Salesperson is very excited. He has just been offered a position by ABC Corp., a promising start-up company, to be their salesperson for their brand new medical software system in the territory of Pennsylvania and New Jersey. The head of human resources hands him a document entitled "Noncompete Agreement" and tells him he will need to sign it before he can officially be hired. Excited about the opportunity ahead, Sam signs the document, which prohibits him from working for a competitor in Pennsylvania or New Jersey for one year after he leaves ABC Corp.*

*Sam starts work and does a good job for ABC Corp., but then one day he has a dispute with his boss and leaves to work for a competitor...*

Section two of this article will provide a brief introduction to employer-employee noncompete agreement<sup>1</sup> analysis and explore the preliminary issue of consideration.

Section three will analyze the criteria and differing approaches courts use to determine the validity of a noncompete agreement, including the requirement of an employer's legitimate business interest and the reasonableness of the occupational limitations and the geographic and temporal scope of the agreement. Section four will survey the current judicial and statutory responses to unreasonable terms in a noncompete agreement.

Sections five and six critique the varying approaches and suggest a model statute to

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<sup>1</sup> These types of agreements are known by several terms, including "Covenant not to Compete" and "Noncompetition Agreement." This article will use the term noncompete agreement.

address unreasonable terms in noncompete agreements. This model will take into account a factor heretofore generally ignored by jurisdictions in their approach to unreasonable noncompete terms: the relationship between consideration and the reasonableness of the agreement.

## II. Overview of Noncompete Agreements

This section first provides a brief introduction to the framework of noncompete agreement analysis and then explores the differing approaches jurisdictions use when addressing the preliminary issue of consideration for a noncompete agreement.

### A. Introduction

Noncompete agreements between employers and employees have been commonplace for over a century.<sup>2</sup> While the precise laws controlling the enforceability of

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<sup>2</sup> Noncompete agreements, and judicial and scholarly analysis of noncompete agreements, have been around for centuries. See *Bendinger v. Marshalltown Trowell Co.*, 994 S.W.2d 468, 471(Ark. 1999) (noting that litigation over noncompete agreements has been around for over 500 years); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 629-646 (1960) (surveying the development of English common law on noncompete agreements). For an historical perspective of noncompete agreements in the United States up through the early 1950s, see the opinion in *Arthur Murray Dance Studios of Cleveland v. Witter*, 105 N.E.2d 685 (Ohio Com Pl. 1952) (The court provides a thorough survey of secondary source materials, which the court colorfully refers to as various "seas" of periodicals, annotations, encyclopedias, and restatements). See also *Zabota Community Center v. Frolova*, 2006 WL 2089828 at \*1 (Mass. Super.):

The legal history of these kinds of situations or agreements dates back at least to 19th Century England. Lord Macnaughten, in *Nordenfeldt v. Maxim Nordenfeldt Guns & Ammunition*, [1894] A.C. 535, at 565, reminded his readers that enforcement of these kinds of agreements is an exception to the general rule. He said:

The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions:

these agreements vary from state to state,<sup>3</sup> the following generic standard, applicable in most jurisdictions,<sup>4</sup> provides a useful framework for surveying the basic principles courts used to determine if a noncompete agreement between an employer and employee will be upheld:

The test applied is whether or not the restraint is necessary for the protection of the business or good will of the employer, and if so, whether the stipulation has imposed upon the employee any greater restraint than is reasonably necessary to protect the employer's business, regard being had to the nature and character of the employment, the time for which the restriction is imposed, and the territorial extent of the locality to which the prohibition extends.<sup>5</sup>

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restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable reasonable, that is, in reference to the interest of the parties concerned and reasonable in reference to the interest of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public. That, I think, is the fair result of all of the authorities.

<sup>3</sup> For a thorough compilation of the laws applicable to noncompete agreements and each jurisdiction, see Brian M. Malsberger, ed., *Covenants Not to Compete: A State-By-State Survey* (4<sup>th</sup> ed. BNA Books 2004). Throughout this article, general propositions will be presented and representative case law will be cited. This article does not purport to capture the subtle nuances of every component of noncompete agreement analysis (many of which are based upon the myriad factual scenarios that develop in employer-employee relationships), particularly in sections two and three, where each of the sub-sections could be the subject of a law review article. The Malsberger book and the ALR articles cited herein provide literally thousands of pages of case law and citations exploring every facet of noncompete agreement analysis and provide a good starting point for research on a particular jurisdictions standards.

<sup>4</sup> *But See* Peter J. Whitmore, *A Statistical Analysis of Noncompetition Clauses in Employment Contracts*, 15 J. Corp. L. 483, 485 (1990) (contending that the variations amongst the jurisdictions make predictability difficult).

<sup>5</sup> *Bennett v. Storz Broadcasting Co.*, 134 N.W.2d 892, 899 (Minn. 1965); *See e.g.* Tex. Bus. & Com.Code § 15.50 (2002):

#### **Criteria for Enforceability of Covenants Not to Compete**

(a) Notwithstanding Section 15.05 of this code, and subject to any applicable provision of Subsection (b), 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,

Most courts also note that the law looks at these contracts with "disfavor"<sup>6</sup> and subjects them to careful scrutiny.<sup>7</sup> This type of verbiage is common in noncompete cases and makes it clear that courts will not treat these types of contracts under the same freedom of contract type of analysis found elsewhere in contract law.<sup>8</sup> Many courts have characterized these agreements as one of "adhesion."<sup>9</sup>

## B. Consideration

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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.

<sup>6</sup> *Sysco Food Services of Eastern Wis., LLC v. Zicarelli*, 445 F.Supp.2d 1039, 1043 (E.D. Wis. 2006) ("[C]ovenants not to compete are generally disfavored in the law."); *Intermountain Eye and Laser Centers, P.L.L.C. v. Miller*, 127 P.3d 121, 127 (Idaho 2005) ("Covenants not to compete in employment contracts are "disfavored"); *Murfreesboro Medical Clinic, P.A. v. Udom*, 166 S.W.3d 674, 678 (Tenn.2005) ("In general, covenants not to compete are disfavored in Tennessee"); *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 460 (Tex. App. Austin 2004) ("A covenant not to compete is a disfavored contract in restraint of trade); *Cranston Print Works Co. v. Pothier*, 848 A.2d 213, 219 (R.I. 2004) ("It is well settled that covenants not to compete are disfavored and subject to strict judicial scrutiny").

<sup>7</sup> *Bennett*, 134 N.W.2d at 898; *See also Vortex Protective Serv. v. Dempsey*, 463 S.E.2d 67, 69 (Ga. App. 1995) (noting that noncompete agreements injure the employees by diminishing their ability to make a livelihood and provide for their family); *Superior Consulting Co., Inc. v. Walling*, 851 F.Supp. 839, 848 (E.D.Mich.1994) (noting that the "public policy disfavoring restraints on trade and interference with a person's livelihood warrants strict examination of noncompetition covenants"); *Herring Gas Co., Inc. v. Whiddon*, 616 So.2d 892, 894 (Miss. 1993) ("the law requires a strict construction of covenants not to compete").

<sup>8</sup> *See e.g. Albee Homes, Inc. v. Caddie Homes, Inc.*, 207 A.2d 768, 772 (Pa.1965) (restrictive covenants ancillary to an employment contract are subject to a more stringent test of reasonableness than those ancillary to a buy-sell agreement).

<sup>9</sup> *Prudential Sec., Inc. v. Plunkett*, 8 F. Supp. 2d 514, 519 (E.D. Va. 1998); *See generally*, J. W. Looney and Anita K. Poole, *Adhesion Contracts, Bad Faith, and Economically Faulty Contracts*, 4 Drake J. Agric. L. 177, 179 (spring 1999) (defining adhesion contracts as "standard form" contracts offered on a "take it or leave it" basis); David Sterkin, *Challenging Adhesion Contracts in California: A Consumer's Guide* 34 Golden Gate U.L.Rev. 285 (spring 2004).

As a preliminary matter, a noncompete agreement must, as with all other contracts, be supported by consideration.<sup>10</sup> Issues arise as to consideration when the noncompete is signed shortly after, but not at or prior to commencement of employment and also when a noncompete is signed well into an established employment relationship.

If the noncompete agreement is signed ancillary to the commencement of employment, the employment itself is sufficient consideration.<sup>11</sup> Some jurisdictions enforce the ancillary requirement strictly and require signing prior to the commencement of employment<sup>12</sup>, while other jurisdictions will consider an agreement ancillary even if signed after the employee begins work.<sup>13</sup> In the latter jurisdictions, the analysis still uses the employee's hiring as the consideration for the agreement, but the court finds a factual basis for determining that the employment had not legally commenced or that the noncompete was agreed to

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<sup>10</sup> *Moore Business Forms, Inc. v. Wilson*, 953 F.Supp. 1056, 1063 (N.D. Iowa 1996) (holding that because noncompetes are contractual agreements they “they must be supported by consideration”); *NBZ, Inc. v. Pilarski*, 520 N.W.2d 93, 96 (Wis. App. 1994)(“restrictive covenants in employment contracts to be supported by consideration”); *RHIS, Inc. v. Boyce*, 2001 WL 1192203 at \*2 (Del. Ch. 2001) (“[o]f course, a covenant to compete must be supported by consideration”)

<sup>11</sup> *Faw, Casson & Co. v. Cranston*, 375 A.2d 463, 466 (1977) (“It is generally agreed that mutual promises of employer and employee furnish valuable considerations each to the other for the contract”) quoting *James C. Greene Co. v. Kelley*, 134 S.E.2d 166 (N.C. 1964).

<sup>12</sup> *Cashman v. National Recruiters*, 332 N.W.2d 736, 741 (Minn. 1982)(Noncompete agreement presented and signed three days after commencement of employment not supported by consideration because the employee receives no benefit); *C.S.C.S., Inc. v. Carter*, 129 S.W.3d 584, 590 (Tex. App.-Dallas 2003) (noncompete signed four days after the commencement of employment not ancillary)

<sup>13</sup> *National Business Services v. Wright*, 2 F.Supp.2d 701, 707 (E.D.Pa. 1998) (agreement signed 10 days after starting work considered ancillary because employee knew of the requirement prior to commencement of employment).

prior to commencement of employment, but simply not signed.<sup>14</sup> For example, if an employer and employee have yet to agree on all important terms of employment, such as pay or commission structure, the court may not consider employment to have commenced, even though the employee has begun work.<sup>15</sup> In other instances, if an employee and employer have agreed on a noncompete agreement ancillary to employment, consideration will be found even though the employee does not sign until after commencement.<sup>16</sup>

If the noncompete agreement is signed after commencement of employment, jurisdictions are split as to whether additional consideration is required.<sup>17</sup> Those holding that no additional consideration is necessary generally focus on the fact that the employee could have otherwise been terminated.<sup>18</sup>

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<sup>14</sup> *Id.* at 707.

<sup>15</sup> *Van Dyck Printing Company v. DiNicola*, 648 A.2d 898, 901 (Conn. Super. 1993), *aff'd*, 648 A.2d 877, 878 (Conn. 1994) (noting that “because [the trial court’s] memorandum of decision fully states and meets the arguments raised in the present appeals, we adopt the trial court’s well reasoned decision as a statement of the facts and the applicable law on these issues. It would serve no useful purpose for us to repeat the discussion therein contained”).

<sup>16</sup> *Young v. Mastrom, Inc.*, 392 S.E.2d 446, 448 (N.C. App. 1990.) (finding a noncompete agreement signed after commencement of employment to be ancillary, reasoning that “It is immaterial that the written contract is executed after the employee starts to work. [citation omitted] However, the terms of a verbal covenant which is later reduced to writing must have been agreed upon at the time of employment in order for the later written covenant to be valid and enforceable.”)

<sup>17</sup> In *Lakeland Employment Group of Columbus v. Columber*, 804 N.E.2d 27, 31-32 (Ohio 2004), the Ohio Supreme Court discussed the current divergent approaches to the issue of whether consideration is required for a noncompete agreement signed after commencement of employment:

Jurisdictions throughout the country are split on the issue presented by the certified question. See, generally, Annotation, *Sufficiency of Consideration for Employee's Covenant Not to Compete, Entered into after Inception of Employment* (1973), 51 A.L.R.3d 825. As summarized by the Supreme Court of Minnesota, “cases which have held that continued employment is not a sufficient

Jurisdictions which require additional consideration<sup>19</sup> to support a noncompete agreement signed after the commencement of employment point to the fact that the employee receives no benefit as result of signing the agreement because the employee already has the position and the agreement itself provides

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consideration stress the fact that an employee frequently has no bargaining power once he is employed and can easily be coerced. By signing a noncompetition agreement, the employee gets no more from his employer than he already has,[ [FN1]] and in such cases there is a danger that an employer does not need protection for his investment in the employee but instead seeks to impose barriers to prevent an employee from securing a better job elsewhere. Decisions in which continued employment has been deemed a sufficient consideration for a noncompetition agreement have focused on a variety of factors, including the possibility that the employee would otherwise have been discharged, the employee was actually employed for a substantial time after executing the contract, or the employee received additional compensation or training or was given confidential information after he signed the agreement." (Citations omitted.) *Davies & Davies Agency, Inc. v. Davies* (Minn. 1980) 298 N.W.2d 127, 130. [footnote omitted]

<sup>18</sup> *Camco, Inc. v. Baker*, 936 P.2d 829, 832 (Nev.1997). ("Today we adopt the majority rule which states that an at-will employee's continued employment is sufficient consideration for enforcing a non-competition agreement."). The *Camco* court further reasoned that: "There is "no substantive difference between the promise of employment upon initial hire and the promise of continued employment subsequent to 'day one.'" quoting *Copeco, Inc. v. Caley*, 632 N.E.2d 1299, 1301 (Ohio App. 1992). The *Camco* court further noted that a "contrary holding might leave the employer in a position of having to fire an at-will employee and then rehire that same employee with the restrictive covenant in place, or have the covenant held unenforceable for want of consideration." 936 P.2d at 832.

See also, *Compass Bank v. Hartley*, 430 F.Supp.2d 973, 978 (D. Ariz 2006) ("the promise of continued employment validates a covenant executed after employment commences"); *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310, 1312 (N.H. 1979); *Daughtry v. Capital Gas Co.*, 229 So.2d 480 (Ala. 1969); *Faw, Casson & Co. v. Cranston*, 375 A.2d 463 (Del.Ch.1977); *M. S. Jacobs & Associates v. Duffley*, 303 A.2d 921 (Penn.1973); *Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d 368 (Iowa 1971); *Farm Bureau Service Co. v. Kohls*, 203 N.W.2d 209 (Iowa 1972).

<sup>19</sup> See generally *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 541(Wyo. 1993)(debating the choice between finding continued employment furnishes the required consideration and requiring additional consideration and holding that requiring additional consideration "recognizes the increasing criticism of the at-will relationship, the usually unequal bargaining power of the parties, and the reality that the employee rarely 'bargains for' continued employment in exchange for a potentially onerous restraint on the ability to earn a living")

no benefit.<sup>20</sup> Those jurisdictions reject the notion that continued employment alone can support a noncompete agreement, finding any claimed consideration to be “illusory”<sup>21</sup> since the employer retained the right to terminate the employee at any time.<sup>22</sup> These jurisdictions will look for an intangible benefit to support the agreement, such as “increased wages, a promotion, a bonus, a fixed term of employment, or perhaps access to protected information.”<sup>23</sup> In still other jurisdictions, courts will look to the specific employment relationship after the signing and allow factors such as a promotion or lengthy employment history to provide the consideration.<sup>24</sup>

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<sup>20</sup> See generally *Cashman v. National Recruiters*, 332 N.W.2d 736, 741 (Minn. 1982) (Holding that a noncompete agreement presented and signed three days after commencement of employment not supported by consideration because the employee receives no benefit); *Poole v. Incentives Unlimited, Inc.*, 548 S.E.2d 207, 209(S.C. 2001) (holding that there is “no consideration when the contract containing the covenant is exacted after several years employment and the employee's duties and position are left unchanged”); *Cox v. Dine-A-Mate, Inc.*, 501 S.E.2d 353, 356 (N.C. App. 1998) (finding no consideration where the “plaintiff received no change in compensation, commission, duties, nature of employment or other consideration in exchange for signing the employment agreement, but rather that he signed it to keep his job”).

<sup>21</sup> *Poole v. Incentives Unlimited, Inc.*, 525 S.E.2d 898, 900 (S.C. App. 1999).

<sup>22</sup> *Id.*

<sup>23</sup> *Labriola v. Pollard Group, Inc.*, 100 P.3d 791, 799 (Wash. 2004).

<sup>24</sup> See *Lakeland*, 804 N.E.2d at 31:

More recently, some courts have found sufficient consideration in an at-will employment situation where a substantial period of employment ensues after a noncompetition covenant is executed, especially when the continued employment is accompanied by raises, promotion, or similar tangible benefits. 6 Lord, *Williston on Contracts* (4th Ed.1995), Section 13:13. These courts thereby implicitly find that the execution of a noncompetition agreement changes the prior employment relationship from one purely at will. *Id.* at 577-584. In effect, these courts infer a promise on the part of the employer to continue the employment of his previously at-will employee for an indefinite yet substantial term. Under this approach, however, neither party knows whether the agreement is enforceable until events occur after its execution.”

The above principles are malleable enough that a court can use them to find consideration even when strict contract principles would otherwise lead to an alternative conclusion. One such example is the Connecticut Supreme Court case of *Van Dyck Printing Company v. DiNicola*.<sup>25</sup> Connecticut is a state that requires that the noncompete agreement be signed ancillary to the commencement of employment or additional consideration is needed.<sup>26</sup> In *Van Dyck*, the employee was hired by the employer as a printing salesman, a new career for the employee.<sup>27</sup> Prior to starting work, the parties orally agreed that the employee would receive \$150 draw against commission, a 7% commission for sales up to \$100,000, and a higher, undetermined, rate for total sales above \$100,000.<sup>28</sup> The parties agreed that eventually a contract would be written up and would include a noncompete agreement.<sup>29</sup> Four weeks after the employee commenced work, he signed an employment agreement which included a noncompete agreement and

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*See also Lawrence and Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 685 N.E.2d 434, 441 (Ill. App. 2 Dist. 1997) (“Continued employment for a substantial period of time is sufficient consideration to support an employment agreement.”) *citing McRand, Inc. v. Van Beelen*, 486 N.E.2d 1306 (1985); *Curtis 1000, Inc. v. Suess*, 24 F.3d 941, 945 (C.A.7 (Ill.) 1994) (finding consideration for a noncompete signed after commencement of employment because employee worked for eight years after signing).

<sup>25</sup> 648 A.2d 898, 901 (Conn. Super. 1993), *aff’d*, 648 A.2d 877, 878 (Conn. 1994) (noting that “because [the trial court’s] memorandum of decision fully states and meets the arguments raised in the present appeals, we adopt the trial court’s well reasoned decision as a statement of the facts and the applicable law on these issues. It would serve no useful purpose for us to repeat the discussion therein contained).

<sup>26</sup> *Artman v. Output Technologies Solutions Eastern Region, Inc.*, 2000 WL 992166 (Conn. Super.). The *Van Dyck* court distinguished the facts of its case from those of a situation where employment had commenced and the employee was asked to sign a noncompete agreement one year after beginning work; in that situation, there was no consideration for the contract. *Van Dyck*, 648 A.2d at 901.

<sup>27</sup> *Van Dyck*, at 900.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

provided slightly higher than 7% for sales of between \$25,000 and \$75,000 and an 8.5% commission on sales over \$75,000.<sup>30</sup> The employee worked for the employer for nearly 20 years, after which he left to begin his own company and within a week was calling on his former customers.<sup>31</sup>

The Connecticut Supreme Court found consideration, theorizing that the open terms in the oral agreement meant that the parties really had not agreed and, therefore, employment had not commenced.<sup>32</sup> The court rationalized that "the fact of [employee's] presence at work [did] not" signify an employment relationship.<sup>33</sup> The court further noted that there was some sort of agreement that the employer would be "protected."<sup>34</sup> Additionally, the court reasoned that even if employment was to be construed as having commenced, the enhanced commission rate would constitute new consideration for the covenant not to compete.<sup>35</sup>

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<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 901.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* The fine line that courts walk in differentiating between consideration and no consideration is also demonstrated in a pair of Minnesota Supreme Court decisions, *Davies v. Davies*, 298 N.W.2d 127 (Minn. 1980) and *Freeman v. Duluth Clinic, Ltd.*, 334 N.W.2d 626 (Minn. 1983). In both, employees signed noncompete agreements after the commencement of employment and neither receive money or other tangible assets at the time of signing. *Davies*, 298 N.W.2d at 129; *Freeman*, 334 N.W.2d at 628. In *Davies*, the employer argued that consideration existed because the employee was promoted from clerk to salesperson and received training as a result of signing the noncompete agreement. *Davies*, 298 N.W.2d at 129. In *Freeman*, the employer argued that consideration existed because the employee, a doctor who was also a shareholder in the clinic, benefited since the clinic was strengthened due to the majority of physicians signing the agreements. *Freeman*, 334 N.W.2d at 630. The *Davies* court found consideration, while the *Freeman* court did not. *Davies*, 298 N.W.2d at 131; *Freeman*, 334 N.W.2d at 630. In both cases the court looked at how similarly situated employees

### III. Analysis of the Noncompete Agreement

Once consideration is found, the court will analyze several components to determine if the noncompete agreement is to be upheld.<sup>36</sup> First, the court must determine if the employer has a legitimate business interest that may be protected by a noncompete agreement. If the employer has a legitimate business interest, the court must then determine whether the noncompete agreement is reasonable in terms of time, geography, and prohibited activities.<sup>37</sup>

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fares. In *Davies*, a brother of the employee in the family owned business (owned by their father), refused to sign a noncompete agreement and remained a clerk. *Davies*, 298 N.W.2d at 131. In *Freeman*, the few doctors who refused to sign were not punished in any way and all doctors, whether they signed or not, receive the same fringe benefits and were compensated under the same pay scale. *Freeman*, 334 N.W.2d at 630.

<sup>36</sup> *Unger v. FFW Corp.*, 771 N.E.2d 1240, 1245 (Ind. App. 2002). The *Unger* court set forth the basic process of analyzing noncompete agreements:

“In determining the reasonableness of the covenant not to compete, we examine whether the employer has asserted a legitimate interest that may be protected by a covenant.’ *Id.* If the employer has asserted a legitimate, protectible interest, we determine whether the scope of the agreement is reasonable in terms of time, geography, and types of activity prohibited. ‘The employer bears the burden of showing that the covenant is reasonable and necessary in light of the circumstances.’ The employer must demonstrate that ‘the former employee has gained a unique competitive advantage or ability to harm the employer before such employer is entitled to the protection of a noncompetition covenant.’” *Id.* at 1244 (citations omitted); see also *C & L Industries, Inc. v. Kiviranta*, 698 N.W.2d 240, 250 (Neb. App. 2005) (noting that the Nebraska Supreme court test is to consider: “the degree of inequality in bargaining power; the risk of the covenantee losing customers; the extent of respective participation by the parties in securing and retaining customers; the good faith of the covenantee; the existence of sources or general knowledge pertaining to the identity of customers; the nature and extent of the business position held by the covenantor; the covenantor’s training, health, education, and needs of his [or her] family; the current conditions of employment; the necessity of the covenantor changing his [or her] calling or residence; and the correspondence of the restraint with the need for protecting the legitimate interests of the covenantee.”).

<sup>37</sup> *Id.* There are two other factors that are often noted by courts: whether the agreement is injurious to the public and a balancing of the harms between the employer’s legitimate interest and the harshness to the employee. If a court finds that either of these factors

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weighs against enforcement, then the noncompete is void and the analysis in this article is not applicable. *See generally Gillespie v. Carbondale and Marion Eye Centers, Ltd.*, 251 Ill.App.3d 625, 626 (5<sup>th</sup> Dist.1993) (“In determining the enforceability of covenants not to compete... courts have focused on numerous factors, including whether enforcement of the contract would be injurious to the public”); *Kallok v. Medtronic, Inc.*, 573 N.W.2d 356, 361 (Minn.1998) (“In determining whether to enforce a particular noncompete agreement or provision, the court balances the employer's interest in protection from unfair competition against the employee's right to earn a livelihood”); *Chambers-Dobson, Inc. v. Squier*, 472 N.W.2d 39, 400 (Neb. 1991)(noting that the “harshness and oppressiveness on the covenantor-employee is weighed against protection of a valid business interest of the covenantee-employer”).

As to the public policy considerations, while, as noted above, courts disfavor noncompete agreements, *see supra*, note 6 and accompanying text, most courts will uphold a noncompete agreement if it protects an employer’s legitimate business interest and is reasonable as to temporal and geographic limitations and as to the scope of the preclusions. *See infra* notes 76-112 and accompanying text. The public policy analysis is most prominent in cases involving physicians. *See e.g. Valley Med. Specialists v. Farber*, 982 P.2d 1277,1284 (Ariz. 1999) (“[a]lthough stopping short of banning restrictive covenants between physicians, the American Medical Association ("AMA") "discourages" such covenants, finding they are not in the public interest.”); *Ohio Urology, Inc. v. Poll*, 594 N.E.2d 1027, 1031 (1991)(noting that the disfavor of noncompete agreements restricting physicians is particularly strong because it greatly effects the public); *see also* Paula Berg, *Judicial Enforcement of Covenants not to Compete Between Physicians: Protecting Doctors' Interests at Patients' Expense*, 45 Rutgers L. Rev. 1,6 (1992)(noting that “[f]or the past 60 years, the American Medical Association (AMA) has consistently taken the position that noncompetition agreements between physicians impact negatively on patient care.”); Serena L. Kafker, *Golden Handcuffs: Enforceability of Noncompetition Clauses in Professional Partnership Agreements of Accountants, Physicians, and Attorneys*, 31 Am. Bus. L.J. 31 (1993); *see generally* James W. Lowery, *Covenants Not to Compete in Physician Contracts: Recent Trends Defining Reasonableness at Common Law* 24 J. Legal Med. 215 (June 2003); Arthur S. Di Dio *The Legal Implications of Noncompetition Agreements in Physician Contracts* 20 J. Legal Med. 457 (Dec. 1999).

As to most other occupations, a primary factor the court will look at in determining if a noncompete is injurious to the public is whether the services that will be precluded are still available to the public. *Redd Pest Control Co., Inc. v. Foster*, 761 So.2d 967, 973 (Miss. App. 2000)(noting that a noncompete agreement limiting an employee from providing pest control services was not injurious to the public, nor did it create a monopoly for the employer, because six or seven other companies were available in the area).

These reasonableness determinations are almost always fact-intensive in nature.<sup>38</sup>

The determinations are also the focus of the remedy analysis in this article.<sup>39</sup> After reviewing the case law analysis pertaining to the reasonableness factors, this section will take a brief look at employer-employee state statutes.

#### **A. Legitimate business interest.**

Most decisions analyzing noncompete agreements begin with an analysis as to whether the employer is protecting a legitimate business interest.<sup>40</sup> The purpose of the

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<sup>38</sup> See *Omni-Plex World Services Corporation v. US Investigation Services, Inc.*, 618 S.E.2d 340, 342 (Va. 2005) (“Each non-competition agreement must be evaluated on its own merits, balancing the provisions of the contract with the circumstances of the businesses and employees involved”).

<sup>39</sup> See *infra* notes 119-154 and accompanying text.

<sup>40</sup> *Weber v. Tillman* 913 P.2d 84 (Kan. 1996) (the four factors a court must examine in determining enforceability a noncompete are whether the contract protects a legitimate business interest, imposes an undue burden on the employee or injures the public, the reasonableness of the geographic and time restrictions) See also A. Scott McDonald, *Noncompete Contracts: Understanding the Cost of Unpredictability*, 10 Tex. Wesleyan L. Rev. 137 (Fall 2003). McDonald notes that among the recognized protectable interests for employers are:

“ reasonable restraints designed:

- (1) to protect trade secrets and confidential information of the company;
- (2) to protect customer goodwill developed for the company (customer relationships);
- (3) to protect overall business goodwill and assets that have been sold (noncompetes used in the sale of a business);
- (4) to protect unique and specialized training;
- (5) for situations in which the employer has contracted for the services of an individual of unique value because of who they are (e.g., performers, professional athletes); and
- (6) for pinnacle employees in charge of an organization.

*Id.* at 143 (and accompanying footnotes);

#### **Wisc. Stat. 103.465 (2002). Restrictive covenants in employment contracts**

A covenant by an assistant, servant or agent not to compete with his or her employer or principal during the term of the employment or agency, or after the

noncompete agreement cannot be to simply make it more difficult for the employee to leave;<sup>41</sup> rather, the agreement must protect a legitimate business purpose for the employer.<sup>42</sup> Further, an employer does not have legitimate interest in protecting against ordinary competition. As one court put it, to prevail an employer must show that: "without the covenant, the employee would gain an unfair advantage in future competition with the employer."<sup>43</sup>

The ways in which an employer may acquire a legitimate business interest in restraining an employee through a noncompete agreement can be roughly grouped into three categories: through an investment in training, by giving the employee access to trade secrets, and by the employee creating goodwill with customers. Of these, the final category is the most common.

**1. Training.** The court will look to see if the employer has invested time and money training the employee and the extent and type of training. If the training consists of routine training that is widely available or that takes minimal time or expense, then the

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termination of that employment or agency, within a specified territory and during a specified time is lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer or principal. Any covenant, described in this subsection, imposing an unreasonable restraint is illegal, void and unenforceable even as to any part of the covenant or performance that would be a reasonable restraint.

<sup>41</sup> *Allen, Gibbs & Houlik, L.C. v. Ristow*, 94 P.3d 724, 726 (Kan. App. 2004); *Unger*, 771 N.E.2d 1240 at 1244 ("To show a legitimate protectible interest, 'an employer must show some reason why it would be unfair to allow the employee to compete with the former employer.'" quoting *Titus v. Rheitone, Inc.*, 758 N.E.2d 85, 92 (Ind. Ct. App. 2001)).

<sup>42</sup> *Compass Bank v. Hartley*, 430 F.Supp.2d 973, 978 (D. Ariz 2006) ("A covenant not to compete is generally enforceable as long as it is no broader than necessary to protect an employer's legitimate business interests"); *Caring Hearts Personal Home Services, Inc. v. Holey*, 130 P.3d 1215 (Kan. App. 2006) ("only legitimate business interests may be protected by a noncompete agreement").

<sup>43</sup> *Vantage Technology, LLC v. Cross*, 17 S.W.3d 637, 644 (Tenn. Ct. App. 1999)

employer probably does not have a legitimate business interest in the training.<sup>44</sup> An employer also does not have a legitimate business interest in protecting against the use of generally available training.<sup>45</sup> Additionally, “[i]n determining the legitimacy of the interest the employer seeks to protect, the court will take into account the employee's time<sup>46</sup> and monetary investment<sup>47</sup> in the employee's skills and development of his craft.”<sup>48</sup> Further, an employer only has a protectable interest in restraining an employee's unique knowledge and skills which were obtained through training with the employer.<sup>49</sup> So, if the employer spends several weeks or months training an employee on the employer's own technical products, it probably has a legitimate business interest to protect.<sup>50</sup>

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<sup>44</sup> *Id.* at 645; *7's Enterprises, Inc., v. Del Rosario*, 143 P.3d 23, 31 (Haw. 2006) (noting that “[s]pecialized or unique training, as distinguished from general skills” is a protectable)

<sup>45</sup> *See Moore Business Forms, Inc. v. Foppiano*, 382 S.E.2d 499, 502 (W. Va. 1989): “[w]hen the skills and information acquired by a former employee are of a general managerial nature, such as supervisory, merchandising, purchasing and advertising skills and information, a restrictive covenant in an employment contract will not be enforced because such skills and information are not protectible employer interests.”

<sup>46</sup> *See also Orkin Exterminating Co. v. Burnett*, 146 N.W.2d 320 (Iowa 1967) (enforcing noncompetition agreement where employee had been given eight weeks training in exterminating insects and methods of operation).

<sup>47</sup> *See also Dain Bosworth Inc. v. Brandhorst*, 356 N.W.2d 590, 593-94 (Iowa App.1984)(\$20,000 training investment created a legitimate business interest).

<sup>48</sup> *Brunswick Floors, Inc. v. Guest*. 506 S.E.2d 670, 673 (Ga. App. 1998) quoting *Beckman v. Cox Broadcasting Corp.*, 296 S.E.2d 566 (Ga. 1982).

<sup>49</sup> *Vantage Technology*, 17 S.W.3d at 645 (“whether an employer has a protectable interest in its investment in training an employee depends on whether the skill acquired as a result of that training is sufficiently special as to make a competing use of it by the employee unfair.”); *see also Brentlinger Enterprises v. Curran*, 752 N.E.2d 994, 1002 (Ohio App. 10 Dist. 2001) (one factor to consider in determining reasonableness of a noncompete is whether the agreement will stifle pre-existing skills).

<sup>50</sup> *Vantage Technology*, 17 S.W.3d at 645; compare *7's Enterprises, Inc., v. Del Rosario*, 143 P.3d 23, 32 (Haw. 2006) (evidence that the sales training included “something secret” and that the training was specifically designed and solely developed by employer over a number of years and was not being utilized by other companies sufficient to create

An example of the type of unique training which will create a legitimate business interest can be found in *Aero Kool Corp. v. Oosthuizen*<sup>51</sup>. In *Aero*, the employee had no prior experience in aviation repair when he was hired by the employer, an aviation repair company.<sup>52</sup> The employer provided him 195 hours of training, which allowed him to be certified by the FAA.<sup>53</sup> After failing a drug test, the employee was fired and then hired shortly thereafter by the employer's competitor.<sup>54</sup> The appellate court reversed the trial court's denial of the employer's request for a temporary injunction, noting that the employee had no prior experience and received certification by the FAA due to the training.<sup>55</sup>

**2. Trade secrets / confidential information.** Noncompete agreement analysis occasionally crosses over with analysis of a confidentiality agreement protecting trade secrets. This term is oftentimes used loosely by courts in noncompete agreement analysis to refer to items such as customer lists and methods of operation which may or may not be considered "trade secrets" under laws regulating trade secrets.<sup>56</sup> Of course, if the

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a legitimate business interest) *with Moore Business Forms*, 382 S.E.2d at 501-02 (no legitimate business interest when training not unique or specialized to the company and the information disseminated was readily available to competitors).

<sup>51</sup> 736 So.2d 25 (Fla. 3d Dist. App. 1999)

<sup>52</sup> *Id.* at 25.

<sup>53</sup> *Id.* at 25-26

<sup>54</sup> *Id.* at 26.

<sup>55</sup> *Id.* The *Aero* court distinguished the case of *Austin v. Mid State Fire Equip. of Central Florida*, 727 So.2d 1097 (Fla. 5<sup>th</sup> Dist. App. 1999), where an employee already had extensive industry experience prior to being hired and had not received any specialized knowledge from the employer.

<sup>56</sup> See generally *Markovits v. Venture Info Capital, Inc.*, 129 F.Supp.2d 647, 657 (S.D.N.Y. 2001) ("A trade secret is any formula or combination of information that is used in business and gives its owner a competitive advantage over others in the marketplace who do not have access to it.").

employee is under a confidentiality agreement, the employee cannot disclose the trade secrets, whether a noncompete agreement is in place.<sup>57</sup>

An example of “trade secret” analysis in the context of a noncompete agreement can be found in *Bed Mart, Inc v. Kelley*<sup>58</sup>, in which the employee had access to the access to the company's "Product Bible," which contained information about all the merchandise in the stores and the wholesale prices of those items, as well promotional deals from suppliers.<sup>59</sup> In reversing the trial court’s decision that a six month restriction was unreasonable, the court reasoned in part that the “Product Bible” was updated every six months, so the employee would have a competitive advantage were he to go to work for a competitor while the book was still valid.<sup>60</sup>

**3. Customer Contacts.** The most common way a legitimate business interest is created is through the employee’s contact with customers. This line of analysis, also referred to as protecting the employer's "goodwill," focuses on the relationship between the employee and the employer's customers. As one court stated: “good will” is broader, than simply the names, addresses and requirements of customers, or some pricing information, it also includes the advantageous familiarity and personal contact that employees, . . . , derive from their dealings with the employer's customers.”<sup>61</sup> To determine if an employee’s customer contacts are sufficient to create a legitimate business interest for the employer, courts look to see if the employee has become the face

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<sup>57</sup> See generally Carol M. Bast, *At What Price Silence: Are Confidentiality Agreements Enforceable?* 25 Wm. Mitchell L. Rev. 627 (1999) (Discussing confidentiality agreements in the context of tobacco litigation).

<sup>58</sup> 45 P.3d 1219 (Ariz. App. Div. 1 2002)

<sup>59</sup> *Id.* at 1222.

<sup>60</sup> *Id.* at 1223.

<sup>61</sup> *Standard Register Co. v. Cleaver*, 30 F.Supp.2d 1084, 1094 (N.D. Ind. 1998).

of the company in the minds of the employer's customers.<sup>62</sup> Perhaps the most common example is the outside salesperson who visits customers at their work places.<sup>63</sup> In this situation, the employee is likely to be the only real contact between the employer and the customer.<sup>64</sup>

In determining if an employer has a legitimate business interest to protect under this category, courts will look at the nature and extent of the contact between the employee and they customer, and also the type of product being delivered.<sup>65</sup> Particularly in a situation where the employer's products are similar to others in the marketplace, "[t]he possibility is present that the customer will regard, or come to regard, the attributes of the employee as more important in his business dealings than any special qualities of the product or service of the employer."<sup>66</sup>

Once it is determined that the employer has a legitimate interest to protect, the next issue is whether the limitations on the employee as to the potential customers the

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<sup>62</sup> *Vantage Technology*, 17 S.W.3d at 645.

<sup>63</sup> See e.g. *Standard Register*, 30 F.Supp.2d at 1088 (salesperson/ business forms); *Safety-Kleen Systems, Inc. v. Hennkens*, 301 F.3d 931, 933 (C.A.8 2002) (customer rep "only normal contact" with the customer); *Wright Medical Technology, Inc. v. Somers*, 37 F.Supp.2d 673, 674 (D.N.J. 1999)(medical sales representative).

<sup>64</sup> See e.g. *North American Products Corp. v. Moore*, 196 F.Supp.2d 1217 (M.D.Fla. 2002) (in a case involving a sales representative, court noted that "an employer has a legitimate business interest in prohibiting solicitation of its customers with whom the employee has a substantial relationship"); *American Fidelity Assurance Corp. v. Leonard*, 81 F.Supp.2d 1115, 1120 (D.Kan. 2000) (upholding agreement where the employee representative was sole contact with the customer).

<sup>65</sup> *Standard Register Co.*, 30 F.Supp.2d at 1095-96. The court also noted that "in industries where personal contact between the employee and customer are especially important due to similarity in the product offered by competitors, the advantage acquired through the employee's representative contact with customers is part of the employer's good will, irrespective of whether or not the employee had access to confidential information." *Id.* at 1095 quoting *Field v. Alexander & Alexander of Indiana, Inc.* 503 N.E.2d 627, 633 (Ind. App. 1987).

<sup>66</sup> *C & L Industries, Inc. v. Kiviranta*, 698 N.W.2d 240, 248 (Neb. App. 2005) quoting *American Sec. Servs. v. Vodra*, 385 N.W.2d 73, 78 (Neb. 1986).

employee may contact and the types of positions the employee may accept during the tolling of the noncompete are reasonable. The court also must determine whether the temporal and geographic limitations in the noncompete agreement are reasonable.

### **B. Reasonableness of Limitations on Customer Contact and Employment Positions**

Of course, simply because an employer has a legitimate business interest to protect does not mean the employer may broadly preclude the employee from any type of competition. The agreement must be narrowly tailored to preclude only those positions and customer contacts necessary to protect the employer's legitimate business interests.<sup>67</sup>

Agreements may be found to be overly broad when the employer seeks to preclude the employee from any position that competes with the employer, even if dissimilar to the employee's duties with the employer. For example, a noncompete agreement precluding a dentist from competing with his former employer in both oral surgery and general dentistry was unreasonably broad because the dentist only practiced oral surgery with the employer.<sup>68</sup> Similarly, a noncompete agreement precluding a truck parts sales person from working "in any capacity ... whatsoever ... in any business activities ... competitive with those of [the employer]" was overly broad as the employer had interests beyond the area in which the employee sold.<sup>69</sup>

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<sup>67</sup> *Lawrence and Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 685 N.E.2d 434, 442 (Ill. App. 2 Dist. 1997) ("Activity restrictions, like restrictions on competing or soliciting, should be narrowly tailored to protect only against activities that threaten the employer's interest."); *Concord Orthopaedics Professional Ass'n v. Forbes*, 702 A.2d 1273, 1276 (N.H. 1997) (holding that a noncompete agreement must be narrowly tailored "to encompass only legitimate interests of the employer").

<sup>68</sup> *Karpinski v. Ingrassi*, 268 N.E.2d 751, 754 (N.Y. App. 1971). This is an example of a noncompete agreement term which is "severable," as discussed *infra* notes 131-142 and accompanying text.

<sup>69</sup> *McNeilus Companies, Inc. v. Sam*, 971 S.W.2d 507, 510 (Tex. App.-Dallas 1997); see also *Motion Control Systems, Inc. v. East*, 546 S.E.2d 424, 426 (Va. 2001) (finding a

Since employers are generally most concerned with protecting customer relationships, a common issue in noncompete agreement litigation is whether the agreement reasonably defines which customers the employee may not solicit. Generally, the employer must be careful to narrowly limit the customer preclusion.<sup>70</sup>

Noncompete agreements which preclude the employee from contacting any of the employer's are usually found unreasonable; the preclusion must generally be limited to only the customers who dealt with the employee.<sup>71</sup> Also, it is generally unreasonable to preclude the employee from contacting former clients.<sup>72</sup> However, it may even be

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noncompete agreement overly broad when the employer defined a "similar business" as "any business that designs, manufactures, sells or distributes motors, motor drives or motor controls," which the court found "could include a wide range of enterprises unrelated to" the employer's business); *Ken's Stereo Video Junction, Inc. v. Plotner*, 560 S.E.2d 708, 710 (Ga. App. 2002) (finding a noncompete agreement overly broad when it precluded a car stereo and security system installer from working for a competitor in any capacity, even as a janitor); *Harville v. Gunter*, 495 S.E.2d 862, 864 (Ga. App. 1998) (finding it unreasonable to prohibit a speech pathologist from being an officer or director of a company engaged in speech pathology because being an officer or director is markedly different than being a speech pathologist); *Pathfinder Communications Corp. v. Macy*, 795 N.E.2d 1103, 1114 (Ind. App. 2003) (finding unreasonable a term in the noncompete agreement with a former employee, a radio disc jockey, holding that he "will not engage in activities," at a competing station as being unreasonably broad because it extended far beyond the employer's interests and employee as a disc jockey).

<sup>70</sup> See e.g. *Product Action International, Inc. v. Mero*, 277 F.Supp.2d 919, 926 (S.D. Ind. 2003) (finding noncompete provision unreasonable where it "fails to impose any reasonable limit in terms ... customers")

<sup>71</sup> See *Advance Technology Consultants, Inc. v. Roadtrac, LLC*, 551 S.E.2d 735, 738 (Ga. App. 2001) (finding a noncompete agreement to be overly broad where it precluded the employee from contacting any of the employer's customers, even those with whom the employee never worked); *Professional Business Services Co. v. Rosno*, 680 N.W.2d 176, 186-87 (Neb. 2004) (unreasonable to prohibit former employee from soliciting customers of employer with whom the employee did not have substantial or any personal contact); *DCS Sanitation Management, Inc. v. Casillo*, 435 F.3d 892, 898 (C.A.8. 2006) (finding overbroad a term precluding former employee from soliciting any customer "having business dealings" with the employer).

<sup>72</sup> *Philip G. Johnson & Co. v. Salmen*, 317 N.W.2d 900, 904 (Neb. 1982) (a former employer "certainly can have [no interest] in its former clients"); *Equity Enterprises, Inc.*

reasonable to preclude the employee from contacting current customers, if those customers pre-existed the employment relationship.<sup>73</sup> Finally, precluding an employee from contacting the employer's potential customers will most often be held unreasonable.<sup>74</sup>

### C. Reasonableness of the Temporal Limitation

All noncompete agreements have, or should have, a specific time after which the agreement expires.<sup>75</sup> Once again, the court will carefully scrutinize this term to ensure that it is reasonable. And, once again, what is reasonable is fact intensive based upon the employee and the industry.

In analyzing whether a certain temporal limitation is reasonable, courts generally look at two factors:

1. The time necessary to hire and train a replacement; and
2. The time necessary to obliterate the connection between the customer and the departing employee.<sup>76</sup>

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*v. Milosch*, 633 N.W.2d 662, 670 (Wis. App. 2001) (finding unreasonable a noncompete term which prohibited former employee from contact with any customer of employer whom employee serviced at "any time" during his employment; the restriction would prohibit employee from doing business with a customer he serviced during the first weeks of his 15-year employment) *Rosno*, 680 N.W.2d at 186-87 (unreasonable to prohibit former employee from soliciting former customers of employer).

<sup>73</sup> *Prairie Eye Center, Ltd. v. Butler*, 713 N.E.2d 610 (Ill. App. 4.Dist. 1999).

<sup>74</sup> *Freiburger v. J-U-B Engineers, Inc.*, 111 P.3d 100, 107 (Idaho 2005) (find a noncompete agreement overly broad, in part, because it precluded employee from soliciting "pending" customers)

<sup>75</sup> See generally *Diversified Fastening Systems, Inc. v. Rogge*, 786 F.Supp. 1486, 1492 (N.D.Iowa 1991) ("The failure to limit the time period and geographical restriction essentially make the contract one imposing a restrictive covenant of unlimited time and space. Such an unlimited covenant is clearly unreasonable and unenforceable."); but see C.T. Dreschler, *Enforceability of Restrictive Covenant, Ancillary to Employment Contract, As Affected by Duration of Restriction*, 41 A.L.R.2d 15 (1955) (listing cases purporting to support the notion that the lack of a time limitation does not render the noncompete agreement ipso facto unenforceable).

<sup>76</sup> *Davies v. Davies*, 298 N.W.2d 127, 131 (Minn. 1980)

In short, the employer should be returned to its whole status before the departing employee is allowed to help a competitor.<sup>77</sup> Most often both of the above factors are considered when determining the reasonableness of the time restriction because most contested noncompete agreements involve employees with customer contacts. Noncompetes may be, however, upheld as to employees without customer contacts. Most courts will look for an employee whose services are “special, unique or extraordinary’ and not merely of ‘high value to his employer,’”<sup>78</sup> Also, it generally must be shown that the employee’s services are “of such character as to make his replacement impossible or that the loss of such services would cause the employer irreparable injury.”<sup>79</sup> In *Parma International, Inc. v. Bartos*<sup>80</sup>, the employee provided the company with special designs and improvements in the manufacturing of model cars.<sup>81</sup> In upholding a one year restriction, the court also noted that the employee was also instrumental in taking the company from a cottage industry to five million dollar per year in revenues over the employee’s six years.<sup>82</sup>

However, the more common point of analysis, especially positions that would reasonably require a noncompete agreement, is that of the amount of time necessary for the new employee to reasonably replace the departing employee in the minds of the

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<sup>77</sup> See *Valley Med. Specialists v. Farber*, 194 Ariz. 363, 982 P.2d 1277,1284 (1999)(“An employer may also have a legitimate interest in having a “reasonable amount of time to overcome the former employee's loss, usually by hiring a replacement and giving that replacement time to establish a working relationship.”) quoting Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 62 (1960)).

<sup>78</sup> *Brentlinger Enterprises v. Curran*, 752 N.E.2d 994, 1002 (Ohio App. 10 Dist. 2001) quoting *Parma Internatl., Inc. v. Bartos*, 1990 WL 11716 (Ohio App. 9 Dist. 1990);

<sup>79</sup> *Brentlinger*, 752 N.E.2d 994 at 1002.

<sup>80</sup> 1990 WL 11716 ((Ohio App. 9<sup>th</sup> Dist. Feb. 7, 1990)

<sup>81</sup> *Id.* at \*3

<sup>82</sup> *Id.* at \*2

customers. This is a fact-intensive analysis, as demonstrated in *Standard Register Co. v. Cleaver*.<sup>83</sup>

In *Standard*, the employee sold business forms and specialty printing items. Prior to commencing employment he signed a noncompete precluding him from selling to the employer's customers for two years after the employment relationship ended.<sup>84</sup> The employee developed close relationships with his customers and visited major customers every two weeks, regardless of their ordering schedule.<sup>85</sup> The employee was generally the sole contact with the customer.<sup>86</sup> Soon after the employment relationship ended, the employee began selling for a competitor in his former territory.<sup>87</sup>

The court framed the temporal limitation legal issue as: "After what period of time will the customer cease to be influenced by the personal relationship the employee was able to establish while in the employ of his employer?"<sup>88</sup> The court noted that, in making this determination, the court will look at the regularity and frequency of the contacts between the employee and the customer.<sup>89</sup> If the employee has frequent contacts with the customer, a shorter duration will be necessary to replace the employee, assuming the new employee commences with a similar visitation schedule.<sup>90</sup>

Since the employee in *Standard* made very frequent visits to his customers, at first blush it would seem that two years would be an unreasonable restraint. However, the court upheld the two year restriction, relying on two points of analysis. First, the visits

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<sup>83</sup> 30 F.Supp.2d at 1095

<sup>84</sup> *Id.* at 1090

<sup>85</sup> *Id.* at 1089.

<sup>86</sup> *Id.* at 1090.

<sup>87</sup> *Id.* at 1091.

<sup>88</sup> *Id.* at 1098.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

themselves could be characterized as progressive, as the employee learned more and more on each visit about how the customer's business was organized, the key personnel, and even through socializing events.<sup>91</sup> Secondly, major customers oftentimes used a "test order" process in which the employee had to get to know the customer's business and the customer determined if it would take the product, a process which usually took several months.<sup>92</sup> Thus, even though the employee's contact with the customer was frequent and regular, two years was a reasonable restriction because the new employee would have to make several visits to acquire the knowledge and understanding of the customer's business to truly replace the departing employee, especially in an industry where the difference between competing projects was "razor thin" and the knowledge of and relationship with the customer was key to the employer's success.<sup>93</sup>

#### **D. Reasonableness of the Geographic Limitation**

A noncompete agreement also usually includes a limitation on where the employee may seek employment.<sup>94</sup> As with the temporal limitation analysis, the determination of whether a geographic limitation is reasonable is fact intensive.<sup>95</sup> The general rule is that the "contractual prohibitions must be geographically limited to what is

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<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at 1096.

<sup>94</sup> See generally C.T. Drechsler, *Enforceability of Restrictive Covenant, Ancillary to Employment Contract, as Affected by Territorial Extent of Restriction*, 43 A.L.R.2d 94 (1955).

<sup>95</sup> *Wausau Mosinee Paper Corp. v. Magda*, 366 F.Supp.2d 212, 220 (D. Me. 2005) ("the reasonableness of a noncompetition covenant...must be determined by the facts developed in each case as to its duration, geographic area").

reasonably necessary to protect the employer's business.”<sup>96</sup> The geographic limitation is written either as an actual geographic “line”<sup>97</sup> or in terms of customers.<sup>98</sup>

A traditional geographic limitation simply precludes the employee from working in a particular county or state or mile radius.<sup>99</sup> In determining reasonableness, there is, however, a focus on customers.<sup>100</sup> For example in *Herring Gas Co., Inc. v. Magee*<sup>101</sup>, a propane salesman was precluded from working within fifty miles of both existing and future locations.<sup>102</sup> In limiting the noncompete to only those locations in existence at the time the employment relationship ended, the court noted that “The primary right of the employer is that of protecting the business from loss of customers by the activities of the former employees who have peculiar knowledge of and relationships with the employer's customers.”<sup>103</sup> The court reasoned that no such knowledge could be acquired outside of

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<sup>96</sup> *Wolf v. Colonial Life and Acc. Ins. Co.*, 420 S.E.2d 217, 222 (S.C. App. 1992)

<sup>97</sup> See e.g. *Deming v. Nationwide Mut. Ins. Co.*, 905 A.2d 623, 637 (Conn. 2006) (25 mile radius); *Maine Eye Care Associates P.A. v. Gorman*, 890 A.2d 707, 709 (Me. 2006) (30 mile radius); *Jenkins v. Eckerd Corp.*, 913 So.2d 43, 53-54 (Fla. App. 1 Dist. 2005) (five square miles); *King v. Head Start Family Hair Salons, Inc.*, 886 So.2d 769, 770 (Ala. 2004) (two mile radius).

<sup>98</sup> *Wolf*, 420 S.E.2d 217 at 222 (“Prohibitions against contacting existing customers can be a valid substitute for a geographic limitation”).

<sup>99</sup> *Camco, Inc. v. Baker*, 936 P.2d 829, 834 (Nev.1997) (noncompete agreement prohibiting former management employees from competing with employer within 50 miles of any location in which employer has targeted expansion to be too broad, noting that “[t]o be reasonable, the territorial restriction should be limited to the territory in which appellants [ (former employers) ] established customer contacts and good will.” citing *Weatherford Oil and Tool Co. v. Campbell*, 327 S.W.2d 76, 77 (Tex.Civ.App.1959) (holding geographical restriction “in any area where [employer] may be operating or carrying on business” void as unlimited as to territory).

<sup>100</sup> See *Stringer v. Herron*, 424 S.E.2d 547, 548 (Ct. App. S.C. 1992)(Fifteen mile radius restriction held unreasonable when an “overwhelming majority” of employer’s clients lived much closer than fifteen miles from business)

<sup>101</sup> 813 F. Supp. 1239 (S.D. Miss. 1993).

<sup>102</sup> *Id.* at 1245.

<sup>103</sup> *Id.*

the areas surrounding existing employer locations.<sup>104</sup> A geographic limitation based on a specific county or state line or mile radius is the easiest to analyze and is more likely to be seen as reasonable when the business is one in which the customers seek out the business.<sup>105</sup>

On the other hand, some employment situations, particularly those in which the employee seeks out and/or visits the customer, do not lend themselves to a clear-cut traditional geographic limitation. In many such situations, the so-called geographic limitation is written in terms of customers.<sup>106</sup> For example, the noncompete may be drafted to preclude the employee not from a specific mile radius or other geographic boundary, but in terms of not contacting former customers.<sup>107</sup> In *Wolf v. Colonial Life and Acc. Ins. Co.*, the noncompete precluded the employee insurance agent from contacting existing policy holders and accounts.<sup>108</sup> The employee argued that this effectively precluded him from customers throughout the country. The court reasoned

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<sup>104</sup> *Id.*

<sup>105</sup> *Unger v. FFW Corp.*, 771 N.E.2d 1240, 1245 (Ind. App. 2002) (Bank employee's noncompete agreement reasonable when it extends to the county where the bank is located and to the immediately surrounding counties, as it is not unusual for a bank to have customers from an adjacent county) *but see Klick v. Crosstown State Bank of Ham Lake, Inc.*, 372 N.W.2d 85, 88 (Minn. App. 1985) (Noncompete unenforceable when bank employee has no special relationships with customers).

<sup>106</sup> *See Robert S. Weiss and Associates, Inc. v. Wiederlight*, 546 A.2d 216, 220 (Conn. 1988) (lack of a specific geographic limitation acceptable when noncompete agreement precluded employee from soliciting employer's existing accounts for two years); *Norlund v. Faust*, 675 N.E.2d 1142, 1155 (Ind. App. 1997) ("The use of territorial boundaries is only one method of limiting a covenant's scope, and when a covenant not to compete contains a restraint which clearly defines a class of persons with whom contact is prohibited, the need for a geographical restraint is decreased.").

<sup>107</sup> *Crown It Services, Inc. v. Koval-Olsen*, 782 N.Y.S.2d 708 (N.Y.A.D. 1 Dept. 2004).

<sup>108</sup> *Wolf*, 420 S.E.2d at 222.

that this was appropriate, as the employer did business nationwide and therefore needed such broad protection.<sup>109</sup>

As with the temporal limitation, the reasonableness of a customer-list “geographic” limitation is very fact intensive and raises interesting questions as to the limits of such a restriction.<sup>110</sup> Should the employee be precluded from contacting former customers who no longer were active at the time employment terminated? Or how about potential customers the employee was currently soliciting but had not yet successfully sold?<sup>111</sup> As to the latter, if the employee is marketing a line of generally available products, then the employee probably cannot reasonably be precluded from entities that were not customers at the time of termination. On the other hand, if the employee sells, for example, consulting and information technology solutions to hospitals and medical clinics that carry a high price tag and take several months or even years between initial

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<sup>109</sup> *Id.*

<sup>110</sup> *Herring Gas Company, Inc. v. Magee*, 813 F.Supp. 1239, 1245 (“Reasonableness as to time and space limitations must be determined from the facts of each case.”)

<sup>111</sup> *See UZ Engineered Products Co. v. Midwest Motor Supply Co.*, 770 N.E.2d 1068, 1080 (Ohio App. 10 Dist. 2001) *review denied* 766 N.E.2d 1002 (Ohio 2002) (noncompete agreement precluding employee from contacting potential customers held valid); *Markovits v. Venture Info Capital, Inc.*, 129 F.Supp.2d 647, 659 (S.D.N.Y. 2001) (upheld restrictive covenant precluding employee from contacting even potential customers); *but see UZ Engineered Products Co. v. Midwest Motor Supply Co.*, 770 N.E.2d 1068 (Ohio App. 10 Dist. 2001) (“An employer has a legitimate interest in limiting not only a former employee's ability to take advantage of personal relationships the employee has developed while representing the employer to the employer's established client, but also in preventing a former employee from using his former employer's customer lists or contacts to solicit new customers. (citations omitted). In addition, an employer has a legitimate interest in preventing a former employee from using the skill, experience, training, and confidential information the former employee has acquired during the employee's tenure with his employer in a manner advantageous to a competitor in attracting business, regardless of whether it was an already established customer of the former employer.”).

contact and implementation of the products and services, then the employer may reasonably preclude the former employee from contacting the potential customer.

### **E. Statutory Schemes**

Several jurisdictions have passed statutes pertaining to noncompete agreements. Generally, these statutes do not provide any specific guidelines; rather, they simply codify the basic common law rules requiring a reasonable business interests and reasonable geographic and temporal limitations.<sup>112</sup> This is certainly not surprising, as the variety of employment situations makes drafting specific limitations impossible. The few statutes to do attempt to provide more precise guidance are still too vague or incomplete to provide boiler plate application. For example, the Oklahoma statute proscribes noncompete agreements from prohibiting employees from working in the same industry or field, but does allow the agreements to preclude employees from soliciting "established" customers.<sup>113</sup> The statute does not, however, define the term "established,"

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<sup>112</sup> See e.g., Wis. Stat. §103.465 (2002) ("A covenant by an assistant, servant or agent not to compete with his or her employer or principal during the term of the employment or agency, or after the termination of that employment or agency, within a specified territory and during a specified time is lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer or principal."); Mich. Stat. § 445.774a (2002) ("An employer may obtain from an employee an agreement or covenant which protects an employer's reasonable competitive business interests and expressly prohibits an employee from engaging in employment or a line of business after termination of employment if the agreement or covenant is reasonable as to its duration, geographical area, and the type of employment or line of business"); Or. Stat. § 653.295 (2005).

<sup>113</sup> Ok. Stat. tit. 15 § 219A (2001). **Noncompetition agreements:**

A. A person who makes an agreement with an employer, whether in writing or verbally, not to compete with the employer after the employment relationship has been terminated, shall be permitted to engage in the same business as that conducted by the former employer or in a similar business as that conducted by the former employer as long as the former employee does not directly solicit the

nor does it provide any guidance as to reasonable temporal or geographical limitations. The few statutes that do attempt to address geographic<sup>114</sup> and temporal<sup>115</sup> only provide broad guidelines.

The only specific language that can be found in a survey of state statutes pertains to limitations on who may be restricted. Some statutes specifically preclude noncompete agreements for certain occupations, such as physician<sup>116</sup> or broadcast industry employees.<sup>117</sup> At least one state limits noncompete agreements to only "Executive and management personnel and officers and employees who constitute professional staff to executive and management personnel."<sup>118</sup>

The statutorily mandated terms approach is too rigid. Employment relationships, and the products and services sold and provided, are too varied for fixed terms to operate equitably. These terms are as likely to be inequitable for employees as they are for employers. A one-year limitation would be unreasonable on a salesperson for a distributor of routine office products; that same one-year limitation would be unfair to an employer who provides custom products or services that require long-term planning and servicing between initial contact and the finalization of the sale.

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sale of goods, services or a combination of goods and services from the established customers of the former employer.

*See generally*, Jeb Boatman, *Contract Law: As Clear as Mud: The Demise of the Covenant Not To Compete in Oklahoma*, 55 Okla. L. Rev. 491 (Fall 2002)

<sup>114</sup> S. D. Codified Law. § 53-9-11 (2006) (allowing noncompete agreements that specify an employee may not compete within " within a specified county, first or second class municipality, or other specified area")

<sup>115</sup> *Id.* (allowing a noncompete to extend "for any period not exceeding two years from the date of termination of the agreement"); Col. Rev. Stat. § 8-2-113 (West 2003) (two years).

<sup>116</sup> Col. Rev. Stat. § 8-2-113 (West 2003); Del. Code. Ann. Tit 6 § 2707 (Westlaw current through 2006).

<sup>117</sup> 820 Ill. Comp. Stat. §17/10 (2002).

<sup>118</sup> Col. Rev. Stat. § 8-2-113 (West 2003).

#### IV. Judicial and Statutory Approaches to Unreasonable Terms

While the points of analysis jurisdictions use to determine if the noncompete agreement contains an unreasonable term are fairly consistent, the remedies jurisdictions use vary.<sup>119</sup> There are three basic approaches jurisdictions use in response to an unreasonable term: voiding the agreement, using the "Blue Pencil" doctrine to eliminate an unreasonable term, and using the "Blue Pencil" doctrine to eliminate an unreasonable term and replace it with a reasonable term.<sup>120</sup>

##### A. Agreement Void

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<sup>119</sup> See generally Ferdinand S. Tinio, *Enforceability, Insofar as Restrictions Would be Reasonable, of Contract Containing Unreasonable Restrictions on Competition*, 61 A.L.R.3d 397 (1975).

<sup>120</sup> *Durapin, Inc. v. American Products, Inc.* 559 A.2d 1051, 1058 (R.I. 1989) (discussing the three approaches, arguing that jurisdictions are moving away from voiding agreements towards using one of the "Blue Pencil" approaches); *Corbin on Contracts* describes the judicial options when a covenant not to compete is overbroad:

"[Some] courts interpret or reform the restrictive promise, if possible, so as to make the extent and character of its operation reasonable. Some courts will refuse to enforce any part of the covenant if the covenant was not drafted in the good faith belief that it was valid. Some courts will refuse to enforce any part unless the whole is reasonable. These courts may refuse to partially enforce even when the contract specifically says that it should be partially enforced.

"The approach of enforcing the restriction to the extent it is reasonable is the approach preferred by many modern courts and is in fact a superior approach. To refuse to enforce a covenant entirely, even for a minor deviation from the reasonableness standard, is too harsh a result, given the lack of precision of the reasonableness analysis and the recognized benefit of reasonably restrictive covenants.... Courts that have refused to reform covenants not drafted in the good faith belief that the restraint was valid appropriately safeguarded the legitimate interests of the employee."

15 Arthur L. Corbin, *Corbin on Contracts* § 80.15, at 138-41 (Joseph M. Perillo ed., 2003) (footnote omitted).

In several jurisdictions a noncompete agreement is voided if one term is found to be unreasonable.<sup>121</sup> In at least one instance this result is statutorily mandated.<sup>122</sup> The reasoning behind the “all or nothing”<sup>123</sup> rule is consistent with a fundamental philosophy underlying the analysis of noncompete agreements: to limit the agreements to the minimum restriction necessary to protect the employer’s legitimate business interest.<sup>124</sup> The employer, the reasoning goes, will take great precautions to ensure that it does not include overreaching terms for fear that the entire agreement will be voided.<sup>125</sup>

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<sup>121</sup> See, e.g., *Quality Liquid Feeds, Inc. v. Plunkett*, 2004 WL2809865 (Ark. App. 2004) (“Further, the contract must be valid as written; the court will not apportion or enforce a contract to the extent that it might be reasonable.”) citing *Bendinger v. Marshalltown Trowel Co.*, 994 S.W.2d 468 (Ark. 1999).

<sup>122</sup> Wis. Stat. 103.465 (“Any covenant, described in this subsection, imposing an unreasonable restraint is illegal, void and unenforceable even as to any part of the covenant or performance that would be a reasonable restraint.”)

<sup>123</sup> This phrase was used in *Durapin, Inc. v. American Products, Inc.* 559 A.2d 1051, 1058 (R.I. 1989) citing *Central Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 36 (Tenn.1984).

<sup>124</sup> See generally, *Volt Services Group, Div. of Volt Management Corp. v. Addeco Employment Services*, 35 P.3d 329, 334 (Or. App. 2001)(“The reasonableness of a noncompetition covenant must be determined in view of what is reasonably necessary to safeguard the employer’s protectable interest”); *NBZ, Inc. v. Pilarski*, 520 N.W.2d 93, 95, fn2 (Wis.App.1994)( holding that a noncompete “is lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer or principal”); *Vlasin v. Len Johnson & Co., Inc.*, 455 N.W.2d 772, 776-77 (Neb.1990) (holding that to be upheld the “restriction [must be] reasonable in the sense that it is no greater than is reasonably necessary to protect the employer in some legitimate interest”); *Market America, Inc. v. Christman-Orth*, 520 S.E.2d 570, 578 (N.C. App. 1999)(Holding that a “restraint is unreasonable and void if it is greater than is required for the protection of the promise) citing *Starkings Court Reporting Services v. Collins*, 313 S.E.2d 614, 615 (N.C. 1984).

<sup>125</sup> See *Tatge v. Chambers & Owen, Inc.*, 579 N.W.2d 217, 227 (Wis. 1998) (Noting that the Wisconsin statute requires that a noncompete agreement containing an unreasonable term be declared void and that “This burden was specifically imposed so that “employers possessing bargaining power superior to that of the employees” would not be encouraged “to insist upon unreasonable and excessive restrictions, secure in the knowledge that the promise will be upheld in part, if not in full.”).

In addition, many decisions<sup>126</sup> adhering to the all or nothing rule cite an *in terrorem* affect of noncompete agreements, as announced by Professor Harlan Blake:

"Courts and writers have engaged in hot debate over whether severance should ever be applied to an employee restraint. The argument against doing so is persuasive. For every covenant that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors. Thus, the mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction. If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable. This smacks of having one's employee's cake, and eating it too."<sup>127</sup>

Jurisdictions using the all-or-nothing theory also quote Blake's reasoning that noncompete agreements are quite often akin to contracts of adhesion as the employee oftentimes does not have legitimate bargaining power.<sup>128</sup>

At least one court noted that more recent decisions have rejected the all-or-nothing rule in favor of some form of judicial modification.<sup>129</sup> In the last twenty years, many courts have utilized one of two forms of the "Blue Pencil" doctrine.<sup>130</sup> In one form, the doctrine is used to remove an unreasonable term from the noncompete agreement, leaving the remaining terms to be applied. In the other form the doctrine is used to rewrite the unreasonable term to make it reasonable.

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<sup>126</sup> See e.g. *White v. Fletcher/Mayo/Associates, Inc.*, 303 S.E.2d 746, 749 (Ga. 1983); *Valley Medical Specialists v. Farber, D.O.*, 982 P.2d 1277, 1286 (Ariz. 1999).

<sup>127</sup> Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 682-83 (Feb. 1960).

<sup>128</sup> *Id.* at 683-94; *White*, 303 S.E.2d 746 at 749.

<sup>129</sup> *Durapin*, 559 A.2d at 1058.

<sup>130</sup> *Id.* This author is unaware of the origin of the term "Blue Pencil," although it is believed to be the color pencil used by editors in the past.

## B. The "Blue Pencil" Doctrine Used to Knock-Out Unreasonable Terms

One approach, taken by numerous jurisdictions, is to remove unreasonable terms and enforce the agreement as to the remaining, reasonable provisions.<sup>131</sup> Within these jurisdictions, there exists a difference as to when the doctrine may be used. While some courts will review an agreement more generally to see if certain prohibitions may be removed<sup>132</sup>, most require that the unreasonable term or terms be clearly severable from the reasonable terms.<sup>133</sup> The noncompete in such jurisdictions must be grammatically meaningful after striking out any unreasonable restrictions.<sup>134</sup>

The issue in many cases is whether the unreasonable term is truly severable from the reasonable terms. One aspect courts will look for is whether there is an agreement as to severability in the form of a severability clause.<sup>135</sup> Additionally, and more importantly,

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<sup>131</sup> *Licocci v. Cardinal Associates*, 445 N.E.2d 556, 561 (Ind.1983) ("if the covenant is clearly separated into parts and some parts are reasonable and others are not, the contract may be held divisible"); Mich. Stat. 445.774a **Agreements not to compete; application**

Sec. 4a. (1) An employer may obtain from an employee an agreement or covenant which protects an employer's reasonable competitive business interests and expressly prohibits an employee from engaging in employment or a line of business after termination of employment if the agreement or covenant is reasonable as to its duration, geographical area, and the type of employment or line of business. *To the extent any such agreement or covenant is found to be unreasonable in any respect, a court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited.* (emphasis added).

<sup>132</sup> *Durapin*, 559 A.2d at 1058 (Holding that the best remedy is to allow "unreasonable restraints to be modified and enforced, whether or not their terms are divisible.")

<sup>133</sup> *Product Action International, Inc. v. Mero*, 277 F.Supp.2d 919, 926 (S.D. Ind. 2003) ("if a covenant is clearly separated into parts, and if some parts are reasonable and others are not, the contract may be severed, or "blue penciled," so that the reasonable portions may be enforced").

<sup>134</sup> *Durapin*, 559 A.2d at 1058. *citing Wood v. May*, 438 P.2d 587, 591 (Wash. 1968).

<sup>135</sup> *Rockford Mfg., Ltd. v. Bennet*, 296 F.Supp.2d 681, 688-89, (D.S.C. 2003); *See e.g. Amex Distributing, Inc. v. Macari*, 724 P.2d 596, 604 (Ariz. Ct. App. 1986), which contained the following severability clause:

courts will look for mechanical severability; one court noted that a covenant is severable only where it "is in effect a combination of several distinct covenants."<sup>136</sup> For example, a noncompete term which precludes the employee from soliciting customers of both the employer (parent company) as well as "affiliated companies" is considered two separate agreements which can be severed to remove the (the presumably unreasonable) term "affiliated companies."<sup>137</sup> On the other hand, terms such as "100 miles" or "State of South Carolina" are not severable.<sup>138</sup>

This severability analysis means that when the three above delineated categories of reasonableness<sup>139</sup> – restrictions on customers and positions, time, and geography – are analyzed, two of them, time and geography, are rarely going to be subjected to severance because "severing overly broad time and territory provisions would eliminate clauses inherently necessary to a covenant not to compete."<sup>140</sup>

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*Severability :*

If any court of competent jurisdiction rules that any portion of this Agreement is invalid for any reasons, the remainder of the Agreement shall remain in full force and effect and shall not be affected thereby.

<sup>136</sup> *Rockford Mfg.*, 296 F.Supp.2d at 689 quoting *Somerset v. Reyner*, 104 S.E.2d 344, 348 (1958)). The *Somerset* court notes that:

"A restrictive covenant which contains or may be read as containing distinct undertakings bounded by different limits of space or time, or different in subject matter, may be good as to part and bad as to part. But this does not mean that a single covenant may be artificially split up in order to pick out some part of it that it can be upheld. Severance is permissible only in the case of a covenant which is in effect a combination of several distinct covenants."

*Id.*

<sup>137</sup> *Rockford Mfg.*, 296 F.Supp.2d at 689.

<sup>138</sup> *Id.*

<sup>139</sup> See *supra* notes 68-111 and accompanying text

<sup>140</sup> *Professional Liability Consultants, Inc. v. Todd*, 478 S.E.2d 201 (N.C. Dec 06, 1996)(Adopting the dissenting opinion in *Professional Liability Consultants, Inc. v. Todd* 468 S.E.2d 578, 583 (N.C. App. 996) as its opinion).

Other jurisdictions have rejected a formal severability analysis in favor of a more flexible approach.<sup>141</sup> “Courts adopting this approach ignore the divisibility aspect and exercise their inherent equity powers to modify and enforce covenants whether their phraseology lends itself to severability or not.”<sup>142</sup>

### C. The "Blue Pencil" Doctrine Used to Rewrite Unreasonable Terms

Courts which reject a strict severability analysis may also utilize the Blue Pencil doctrine to not only remove an unreasonable term, but also to rewrite the term to make it reasonable.<sup>143</sup> Under this approach, courts exercise their inherent equity powers to the extent necessary to protect the employer’s legitimate business interest.<sup>144</sup>

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<sup>141</sup> *Durapin*, 559 A.2d at 1058.

<sup>142</sup> *Id.*

<sup>143</sup> *See Herring*, 813 F. Supp. at 1245 (“If a court finds that the limitations contained in a covenant not to compete are unreasonable, then the court will modify the limitations so that they are reasonable.”);

*See e.g.* Bus. and Com.Code § 15.51 **Procedures and Remedies in Actions to Enforce Covenants Not to Compete**

...

(c) If the covenant is found to be ancillary to or part of an otherwise enforceable agreement but contains limitations as to time, geographical area, or scope of activity to be restrained that are not reasonable and impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee, the court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee and enforce the covenant as reformed, except that the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief. If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, the promisor establishes that the promisee knew at the time of the execution of the agreement that the covenant did not contain limitations as to time, geographical area, and scope of activity to be restrained that were reasonable and the limitations imposed a greater restraint than necessary to protect the goodwill or other business interest of the promisee, and the promisee sought to enforce the covenant to a greater extent than was necessary to protect the goodwill or other business interest

An example of the use of the Blue Pencil doctrine to rewrite a noncompete agreement can be found in the Minnesota Supreme Court decision of *Davies v. Davies*.<sup>145</sup> In *Davies*, the employee was a bail bonds account representative, a position which required a license, for his father's firm.<sup>146</sup> The employee signed a noncompete agreement which precluded him from "engaging in the insurance business for a period of five years within a 50-mile radius of Minneapolis, St. Paul, or Duluth."<sup>147</sup> Soon after leaving the agency, the employee began contacting the attorneys he had worked with while at the agency.<sup>148</sup>

The court rewrote the noncompete agreement, limiting it to only one year and to only the county in which the firm did virtually all of its business.<sup>149</sup> The court further edited the agreement to only include actual clients that the employee had contacted.<sup>150</sup>

The underlying reasoning for allowing a court to rewrite terms is that the parties have reached a basic agreement that the employee will be restricted in some manner after the employment relationship ends.<sup>151</sup>

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of the promisee, the court may award the promisor the costs, including reasonable attorney's fees, actually and reasonably incurred by the promisor in defending the action to enforce the covenant.

<sup>144</sup> *Durapin*, 559 A.2d at 1058.; *Westwind Technologies, Inc. v. Jones*, 925 So.2d 166 (Ala. 2005) ("It is clear from our caselaw that, if a covenant not to compete is overbroad, it is within the power of the courts to narrow it.") *citing Kershaw v. Knox Kershaw, Inc.*, 523 So.2d 351, 359 (Ala.1988) ("This Court has previously held that when an agreement in restraint of trade contains unreasonable limitations, the court may strike the unreasonable restriction from the agreement, or the court can enforce the contract within its reasonable limits.")

<sup>145</sup> 98 N.W.2d 127 (1980)

<sup>146</sup> *Id.* at 128.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.* at 131

<sup>150</sup> *Id.*

Whether a jurisdiction uses the blue pencil doctrine solely to eliminate an unreasonable term or it allows a court to rewrite the agreement, the doctrine is generally a discretionary tool.<sup>152</sup> In both types of jurisdictions, courts note that clear overreaching on the part of the employer may preclude a later argument for use of the Blue Pencil doctrine.<sup>153</sup> As one court stated, the Blue Pencil doctrine should be used “unless the circumstances indicate bad faith or deliberate overreaching on the part of the [employer].”<sup>154</sup>

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<sup>151</sup> See *Alexander & Alexander, Inc. v. Wohlman*, 578 P.2d 530 (Wash. App.1978) citing *Wood v. May*, 438 P.2d 587 (Wash. 1968). The Wood court cites with approval S. Williston, Contracts § 1660 (rev. ed. 1937):

If a sharply defined line separated a restraint which is excessive territorially from such restraint as is permissible, there seems no reason why effect should not be given to a restrictive promise indivisible in terms, to the extent that it is lawful. If it be said that the attempt to impose an excessive restraint invalidates the whole promise, a similar attempt should invalidate a whole contract, though the promises are in terms divisible. Questions involving legality of contracts should not depend on form. Public policy surely is not concerned to distinguish differences of wording in agreements of identical meaning.

<sup>152</sup> See e.g. *Hilligoss v. Cargill, Inc.*, 649 N.W.2d 142, 147 (Minn. 2002)(Noting that, in rejecting employer’s contention that the doctrine should have been used to make the agreement reasonable, the Blue Pencil Doctrine may be used at the discretion of the court); *Klick v. Crosstown State Bank of Ham Lake, Inc.*, 372 N.W.2d 85, 88 (Minn. App. 1985)(Holding that use of the Blue Pencil doctrine is discretionary and that the court did not abuse its discretion when it found that the employer was using a noncompete not to prevent unfair competition, but as a tool to keep the employee from leaving).

<sup>153</sup> See *Arpac Corp. v. Murray*, 589 N.E.2d 640 (Ill. App. 1 Dist. 1992) (“Although a circuit court is not prohibited from modifying restraints embodied in an employment contract, the fairness of the restraint initially imposed is a relevant consideration of the court in equity.”); *Kayem v. Stewart*, 2003 WL 22309466 (Tenn. App. 2003.)(“[U]nless the circumstances indicate bad faith on the part of the employer, a court will enforce covenants not to compete to the extent they are reasonably necessary to protect the employer's interest”) citing *Cent. Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 37 (Tenn.1984).

<sup>154</sup> *Durapin*, 559 A.2d at 1058; see also *Data Management, Inc. v. Greene* 757 P.2d 62, 64 (Alaska 1988) (“The third approach, and the one we adopt, is to hold that if an overbroad covenant not to compete can be reasonably altered to render it enforceable, then the court shall do so unless it determines the covenant was not drafted in good faith.

## V. Analysis

Let us return to and expand upon our opening hypothetical:

*Soon after starting with ABC, Sam Salesperson lands a major account in Philadelphia for his first sale. Soon afterward, he lands several other major Philadelphia accounts, due to word of mouth and references within the Philadelphia medical community. Sam is soon spending all of his time maintaining and developing these major accounts and making a good living doing so. ABC hires other salespeople to market in the rest of Pennsylvania and in New Jersey. Three years later, Sam leaves ABC to work for a competitor.*

*Is it fair to find the geographic limitation in the noncompete unreasonable because Sam only sold in Philadelphia? Would it be fair to Sam to preclude him from selling in all of Pennsylvania and New Jersey?*

Even assuming all other terms are reasonable, a close analysis of the geographic limitation in this hypothetical shows the inadequacy of the current approaches and underscores the need for noncompete agreements to become malleable documents that adjust along with the employee's duties. Each of the three current approaches is addressed below, but first a preliminary question, one that is rarely ever explicitly addressed by courts, must be raised:

*At what point do we look at the reasonableness of the terms of the noncompete?*

The two options are, of course, to look at the reasonableness at the time the agreement was signed or at the time the employment relationship ends. While the question is rarely explicitly addressed, its resolution is critical to an evaluation of the reasonableness of a noncompete agreement and also brings to bear the impact that a jurisdiction's rule

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The burden of proving that the covenant was drafted in good faith is on the employer.”); *Estee Lauder Companies Inc. v. Batra*, 430 F.Supp.2d 158, 180 (S.D.N.Y. 2006) (noting that a court may sever terms and partially enforce the agreement if “the employer demonstrates an absence of overreaching, coercive use of dominant bargaining power, or other anti-competitive misconduct, but has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing”); .

regarding consideration for noncompete agreements signed after commencement of employment should play in the overall remedy scheme.<sup>155</sup>

#### **A. Jurisdictions Using the “Agreement Void” Rule**

In jurisdictions utilizing the “all or nothing” approach, the point at which the reasonableness of the agreement is determined is crucial. If a court analyzing the above hypothetical were to look at the reasonableness of the agreement at the time the employment relationship ended, it would certainly find the agreement unreasonable, as the geographic limitation is far greater than necessary to protect its legitimate business interests. In an all or nothing jurisdiction, Sam Salesperson would be free to call on his current customers immediately.

If a court were to look at the reasonableness of the agreement at the time it was signed, it would find the geographic term reasonable, as ABC and Sam certainly envisioned sales throughout the territory. The result would be that Sam would not only be barred from calling on his Philadelphia customers, but would also be unfairly precluded from selling in the rest of Pennsylvania and New Jersey.

These divergent outcomes underscore the need to incorporate a jurisdiction’s rule on consideration for noncompete agreements signed after commencement of employment

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<sup>155</sup> One statute that mandates that a noncompete agreement be analyzed as of the circumstances at time of formation is Texas Stat. 15.50 (“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”). *But see* Wis. Stat 103.465 (noting that a noncompete is lawful and enforceable only if the restrictions imposed are reasonably necessary) and Mich. Stat. 445.774a (“if the agreement or covenant is reasonable”), both of which, while not explicitly directing, indicate that the agreement is to be analyzed as to the applicable facts at the time of termination of employment.

into the overall remedy analysis. If the reasonableness of the agreement as of the time the employment relationship ended, which is common, then employers must have the ability to easily alter the noncompete so that the terms reflect an employee's current duties and responsibilities. It is unrealistic in many employment situations to expect the employer to be able to accurately predict the scope of an employee's duties five, ten, or more years down the road. Territories and customer bases may expand or shrink, new products may be added or the employee may end up focusing on only a few of the employer's products, and technologies and general duties may change. It is unrealistic to require new consideration each time a change takes place. A better approach, as presented below, is to foster a system in which the employer and employee, with adequate safeguards, are encouraged to regularly review and update the noncompete agreement to accurately reflect the employee's duties.

## **B. Jurisdictions Employing the Blue Pencil "Knockout" Rule**

The Blue Pencil "knockout" method is also problematic, as it is unclear how this approach can work as a practical matter with many key noncompete terms. Courts using this method often emphatically state that they do not have the power to rewrite contractual provisions.<sup>156</sup> However, if key terms are simply knocked out, the agreement itself may be unenforceable as a practical matter. For example, in our hypothetical a

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<sup>156</sup> See e.g. *Valley Med. Specialists v. Farber*, 982 P.2d 1277, 1286 (Ariz. 1999) ("the court cannot create a new agreement for the parties to uphold the contract."); *Moore v. Midwest Distribution, Inc.*, 65 S.W.3d 490, 494 (Ark. App. 2002) ("Our supreme court further stated 'that the court would not vary the terms of a written agreement between the parties; to do so would mean that the court would be making a new contract, and it has consistently held that this will not be done.'") quoting *Bendinger v. Marshalltown Trowell Co.*, 994 S.W.2d 468 (1999).

court could not simply knock out the geographical limitation because the noncompete would then read so as to preclude Sam Salesperson from selling anywhere for two years. Certainly the intended consequence of finding a geographic limitation unreasonable is not to extend the prohibition indefinitely. The agreement is simply unenforceable without the geographic limitation.

Of the three primary terms in a noncompete agreement (temporal, geographic, and occupational), the temporal and geographic limitations are required terms. While, occasionally, a portion of the occupational limitation can be knocked out, the temporal and geographic terms must be included. If say, ABC's noncompete agreement precluded Sam Salesperson from marketing software and hardware to ABC's customers, the term "and hardware" could be eliminated and the agreement can still be enforced. However, the parties must know for how long and in what territory Sam is precluded from selling software for the agreement to be workable and enforceable.

### **C. Jurisdictions Using the Blue Pencil "Rewrite" Rule**

On the surface, allowing a court to rewrite on reasonable provisions to make them usable seems to be the most equitable as to the final outcome. Employers receive the protection they contracted for and employees are only restricted to the extent necessary to protect the employer's legitimate business interest. However, there are legitimate concerns over this approach.

First of all, the rewrite approach does nothing to discourage employers from seeking the broadest possible protections at the commencement of the noncompete agreement because the employer can rely on the court to rein in any excesses. While an

employer's fervor can be tempered by a rule which requires good faith in the drafting, the reality is that many of the occupations in which noncompete agreements are most common and needed - sales and "customer contact" positions - began without either the employer or employee knowing where the sales and customer contact leads and development will take the employee. As such, most employers would have at least a reasonable argument for a fairly broad noncompete agreement.

This "good faith" analysis also brings us back to the initial question posed in this section: at what point do we judge the reasonableness of the agreement? If we are to look at the reasonableness at the time of drafting then we must give employers even greater leeway in predicting the scope of the employee's duties at some time in the future.

Further, when reasonableness at the time of drafting is the issue, an analysis of the "good faith" of the employer is rife with potential problems of proof, particularly in regards to those employees who have been with the employer for significant period of time. It is easy to conceive a situation where an experience salesperson/customer contact employee who has been with an employer for 10 years was initially trained and managed by employees that have long since left the company. As such, it often may be difficult to determine whether the original limitations in the noncompete agreement were reasonable based upon the employer's expectation of the employee at the time of hire.

Further, the *in terrorem* effect of a noncompete agreement, espoused by Professor Blake<sup>157</sup> and noted by numerous courts, should not be discounted. Many employees will, when faced with even unreasonable noncompete agreement terms, choose simply to honor the agreement due to lack of legal knowledge and/or for fear of a lawsuit and

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<sup>157</sup> See *supra* note 127 and accompanying text.

accompanying expenses. As such, employers should be discouraged from overreaching in the initial drafting of the noncompete agreement.

Finally, the hesitancy of courts to create terms to an agreement that differ from those agreed upon by the parties is well-founded. Courts should interpret contracts, not create them. A better policy, as discussed above, is to create a system that encourages employers and employees to regularly review and update the noncompete agreement.

In sum, each of the three responses to unreasonable terms is flawed. Voiding an entire agreement for an unreasonable term is, while the best method to discourage overreaching by employers, potentially unfair, particularly to employers who act in good faith at the time of drafting but are unable to precisely determine the scope of the employee's duties as they evolve over the employment relationship. Eliminating an unreasonable term is unworkable for too many agreements because some terms are necessary for the agreement to function; it is inequitable to allow some agreements to be "saved" simply because the employer was fortunate enough to overreach on a term that can be severed. Finally, allowing judicial modification of the agreement rests too much power in the employer's drafting, allowing the employer to seek maximum protection with the knowledge that the court will cure any deficiencies.

## **VI. Proposed Noncompete Agreement Remedy Statute**

The following proposed scheme is designed to encourage employers and employees to reach noncompete agreements at the commencement of employment and then regularly review and update the agreement to reflect the employee's duties. This scheme also takes into account the important role that the rules pertaining to

consideration should play in creating a fair and equitable remedy for unreasonable terms in a noncompete agreement.

### **1. Consideration**

- a. If signed prior to the commencement of employment, no additional consideration is required.<sup>158</sup>
- b. If the noncompete agreement is signed after the commencement of employment, consideration beyond continued employment must be given by the employer. This consideration must be directly linked to the signing of the noncompete agreement and must include one or more of the following:
  - i. A one-time bonus equaling or exceeding 5% of the employee's salary
  - ii. A permanent pay raise equaling or exceeding 3% of the employee's salary
  - iii. For a salesperson: an expanded territory or other marketing opportunities, including additional products or services, which carry a reasonable expectation for a permanent pay increase equaling or exceeding 3% of the employee's salary
  - iv. A promotion which includes a significant increase in title and responsibility.<sup>159</sup>

### **2. Alteration of an Existing Noncompete Agreement**

- a. If a valid noncompete agreement is in place between employer and employee, no additional consideration is necessary for the parties to agree to alter the terms of the agreement.
- b. If an employer wishes to alter a noncompete agreement, the employer must present the noncompete agreement in writing to the employee, with

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<sup>158</sup> This is the standard rule, followed by all jurisdictions.

<sup>159</sup> The reasoning behind section 1(b) is to strongly encourage employers to present noncompete agreements to prospective employees for signing prior to commencement of employment. This rule recognizes that an employee who is presented with a noncompete agreement after commencement of employment is in a very difficult predicament in which the employee has very little bargaining power. This rule requires a significant financial outlay on the part of the employer to support an agreement after commencement of employment.

The rule does, however, provide a reasonable alternative for the employer who wants to promote an employee in a house. Such might be the case with an administrative employee or factory or warehouse employee who wants to move into a sales or executive position. The rule allows for the significant promotion itself to provide the wired consideration. In addition, such a promotion would almost always entail a significant pay raise (or lease the possibility of a pay raise due to commissions).

the employee's rights and responsibilities clearly stated and the changes clearly identified.<sup>160</sup>

- c. Once the employee is presented with the altered noncompete agreement, the employee has twenty-one days to:
  - i. Sign the noncompete agreement as presented;
  - ii. Present a counter-proposal to the employer; or
  - iii. Refuse to sign the altered noncompete agreement<sup>161</sup>

### **3. Remedy for an Unreasonable Term**

- a. If the parties have a signed agreement and the court finds a term to be unreasonable, the agreement is VOID, subject to section (b) of this subdivision.<sup>162</sup>
- b. If the parties have a signed agreement, the employer has presented an altered agreement to the employee and the employee refused to sign the agreement or the parties were unable to reach an agreement following a counter-proposal from the employee, the court may, in its discretion, use the Blue Pencil doctrine to cross out an unreasonable term(s) and replace it with a reasonable term. In determining if it should utilize the Blue Pencil doctrine, the court should consider:
  - i. The reasonableness of the signed agreement
  - ii. The reasonableness of the un-signed, altered agreement
  - iii. The reasonableness of the employee's counter-proposal, if any<sup>163</sup>

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<sup>160</sup> While it may, at first blush, seem unreasonable to require a new agreement, creating the new agreement should be relatively straight forward and require little supervision from the attorney who originally drafted the agreement. The manager would only need to alter the pertinent provisions of the documents to more accurately coincide with the employee's current duties. This may require, for example, altering the geographic term to coincide with current geographic territory or customer list or adding or deleting product lines, any of which can be accomplished by a manager. Further, the document itself can be incorporated into the employee's regular performance review, so as to make the experience less confrontational.

<sup>161</sup> This section allows an employer to alter the terms of an existing noncompete agreement without the need for additional consideration. The reasoning behind this rule is twofold. First, the employer and the employee have already agreed upon some protection for the employer at the termination of the employment relationship. Second, and in conjunction with the terms in subdivision 3, the employer has the ability, and the obligation, to regularly monitor the noncompete agreement to ensure that is reasonable in light of the employee's current duties.

<sup>162</sup> This rule provides the maximum protection for employees, as employers must craft noncompete agreements that are not overly broad and protect only legitimate business interests and monitor those agreements regularly to ensure that an employee's changing work duties are accurately reflected in the agreement.

<sup>163</sup> This section allows for court flexibility in situations in which an employer attempts to alter an existing noncompete agreement, but the employee and employer are not able to agree on altered terms. The court may take that into consideration an employer's attempt

## **Conclusion**

Employer-employee noncompete agreement litigation is not going away. The agreements are too important to employers, too burdensome on employees, and too fact intensive to be eliminated. Courts, and, in particular, legislative bodies should consider the important policy considerations when choosing a remedy for unreasonable terms in a noncompete agreement. Further, the role of consideration in the remedy scheme should be considered to create a scheme that encourages regular review and updating of the noncompete agreement between employers and employees.

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to alter the terms of a noncompete agreement to coincide with an employee's current duties. This section also encourages employees to actively work to reach an agreement with their employer. If an employer has acted in good faith and attempted to update the agreement to coincide with the employee's duties, the court should use the Blue Pencil doctrine to revise any unreasonable terms to make them reasonable.