

**Non-Compete, Non-Solicitation and Confidentiality
After the Job Is Done**

By
Tom Singer

Axilon Law Group, PLLC
115 N. Broadway, Suite 310
P.O. Box 987
Billings, MT 59103-0987
(406) 294-9466
(406) 294-9468 (facsimile)
e-mail: tsinger@axilonlaw.com
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Non-Compete, Non-Solicitation and Confidentiality:

After the Job Is Done

All too often, lawyers get the telephone call only when the battle lines have already formed: an employee or partner or franchisee has resigned and joined a competitor or opened a new business and is taking customers or is using a business concept, perhaps in violation of contractual covenants or trade secret laws, and the former employer or partnership or franchiser is threatening to sue. Both parties run to their attorneys wondering if they have a case.

Sometimes, though, clients actually think ahead: the owner or buyer of a business fears that her employees, a former owner, disgruntled franchisees, or others with knowledge of the business may open a competing business, so she asks her lawyer to insert an iron-clad covenant in a buy-sell agreement, an employment contract, an employee handbook, or a franchise or distribution agreement, intending to preclude any competition, disclosures of confidential information, and solicitation of customers or other employees by the employee, seller, or prospective franchisee. Of course, once the “iron-clad” agreement is presented to an employee, seller, or prospective franchisee, another lawyer often gets asked: “Should I sign it?”

The clients all want to know if such agreements are enforceable, and they all want a simple answer. Unfortunately, there is no simple answer. The answer in any situation will depend on a balancing of the personal and societal interests involved. The interests

being balanced are central to what many people think of as the American way of life: a free market and a free society.

I. Why Are These Issues So Difficult?

Business owners seek to protect their client lists, business methods, and other intellectual property because it is a vital component of the goodwill on which they depend for their income stream and opportunity for growth. Knowing that most of their intellectual property resides in the memories of the people who work in the business, owners hope their employees, franchisees, and co-owners won't leave and go into competition, and they think the law should help them protect their business. Meanwhile, the employees and business partners and franchisees who are leaving businesses think the law should let them use their own capabilities and experiences and contacts to make a living, whether by joining a competitor or by establishing one.

So when an employee or partner or franchisee leaves a business and goes into competition, one or the other may file litigation, allowing a court to decide which of the former compatriots now has the upper hand. In choosing one over the other, the court, knowingly or not, is taking sides in a fierce debate about how best to promote economic growth.

On the one hand, many commentators claim that giving full protection to trade secrets and enforcing covenants not to compete allows the producers of intellectual property to capture all of the gains from their efforts and encourages them and others to produce more ideas, inventions, and other intellectual property that will promote

economic growth and benefit the society as a whole. See, e.g., Michael J. Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* 152-53 (1986).

Such arguments have been made not only in support of non-compete and non-solicitation agreements, but also to promote lengthening the periods of exclusive use for copyrights and patents, and for expanding the rights of owners of trademarks.

On the other hand, many argue that aggressively protecting intellectual property rights actually discourages creativity and entrepreneurship, and that affording maximum economic liberty to individuals, particularly entrepreneurs who generate new ideas and new jobs, is the best way to expand the economy.

Both arguments seem logical, and neither really can be proven empirically, but that does not mean people haven't tried. For example, Professor Ronald Gilson of Stanford Law School has argued that the different approaches taken by the courts of California and Massachusetts regarding covenants not to compete can help explain why the high-tech industry grew so much faster in California's Silicon Valley than along Boston's Route 128. Gilson notes the Silicon Valley and Route 128 were both well-positioned to ride the tech wave. Both hosted major research universities and had well-educated work forces, and were close to transportation and manufacturing hubs. He also notes the Boston area had been more successful at landing lucrative government-funded research contracts in the period after World War II, so that as of 1965, Route 128 had three times as many people employed in technology as Silicon Valley. Yet thirty years later Silicon Valley had surged ahead. By 1990, its technology employment was double

Route 128's. In 1995, Silicon Valley reported the highest gains in export sales of any metropolitan area in the United States, an increase of thirty-five percent over 1994, while Boston was not in the top five. Ronald J. Gilson, "The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete," 74 *N.Y.U. L. Rev.* 575, 587 (1999).

Professor Gilson attributes Silicon Valley's blossoming to "knowledge spillovers between firms through voluntary cooperation and involuntary employee movement." *Id.*, 586. In other words, ideas shared among employees of different companies, often because they changed employers, "repeatedly restart[ed] the industrial life cycle through new innovation...." *Id.* In the 1970s, employee turnover averaged more than thirty-five percent a year at Silicon Valley electronics firms. *Id.*, 590. Some firms early in Silicon Valley's development had tried to restrain turnover by enforcing covenants not to compete, but the California courts refused to cooperate and employers soon accepted "high velocity employment." *Id.*, 596. In Massachusetts, on the other hand, where courts enforced post-employment covenants not to compete, long-term stability in employment and vertically integrated companies that did not share information outside the firm became the norm. *Id.*

Professor Gilson cautions that the Silicon Valley's response to high velocity employment may be attributable in part to the industry or to some accident of geography, and he does not encourage states to emulate California's broad prohibition of covenants not to compete. He suggests, instead, that courts adopt the "rule of reason" (as most

courts, including Montana, already do) and specifically consider the public interest in encouraging economic development by, for example, assessing whether enforcing a non-compete might deter development of an industrial district composed of firms in a related industry (what economists call “potential agglomeration economies”).

Using Gilson’s analysis, lawyers trying to invalidate or enforce a particular covenant not to compete would be presenting expert testimony concerning the “knowledge structure” of the industry in which the clients were involved, and courts would enforce post-employment covenants more aggressively in those industries dependent on "discrete innovation" (where an invention clearly is not the first step in a series of important technical advances – e.g., a ballpoint pen) as opposed to those industries involved in "cumulative technologies" (where it can be anticipated that fundamental technological advances are both possible and will build on existing technology – e.g., computers). *Id.*, 628-29.

Gilson’s analysis is unlikely to matter in most of the cases that arise in Montana because manufacturing and high-tech businesses are a small part of the economy. Most Montana cases seem to have involved services and retail.

Gilson also does not say how his analysis might apply to covenants not to compete in business purchase or franchise agreements. He acknowledges that California’s ban on restraints of trade makes exceptions for contracts for the sales of businesses and dissolutions of partnerships but he does not comment or speculate about whether those exceptions diminished Silicon Valley’s prosperity.

It probably didn't matter. Silicon Valley grew so fast it created a bubble, a bubble that burst soon after Gilson's article was published.

II. Doesn't Montana Follow California Law?

As Professor Gilson notes, the California statutes banning restraints on trade and defining the exceptions were part of the Field Code, which California adopted in 1872. *Id.*, 613-19. In 1895, Montana also adopted the Field Code, including the provisions on restraints on trade. For many years, Montana's "interpretation of these sections w[as] guided by the construction given them by the Supreme Court of California." *Treasure Chemical, Inc. v. Team Laboratory Chemical Corp.*, 187 Mont. 200, 204, 609 P.2d 285, 287 (Mont. 1980).

The statute broadly banning restraints on trade is still in place in both states, but beginning in the 1980s, the exceptions for sales of businesses and dissolutions of partnerships were rewritten in both states so that California's exceptions are broader than Montana's geographically and in other ways. Compare Cal. Bus. & Prof. Code §§ 16601, 16602 & 16602.5 with §§ 28-2-704 & 705, MCA. For example, the exception for the sale of "the goodwill of a business" was amended in California in 2002 to explicitly enforce covenants that bind owners of corporate stock or units in a partnership or LLC when they sell their ownership interest in the entity. The amendment apparently overturned a 2001 court decision that held the exception did not apply to a medical corporation's repurchase of a departing doctor's stock because goodwill had not been a factor in the price. *Hill Medical Corp. v. Wycoff*, 86 Cal.App.4th 895, 907, 103

Cal.Rptr.2d 779, 788 (2001). As the California legislature has expanded the exceptions, the California courts have continued to enforce the broad ban on restraints of trade vigorously, holding that the legislative exceptions “reinforce the conclusion that covenants not to compete in contracts other than for sale of goodwill or dissolution of partnership are void.” *Thompson v. Impaxx, Inc.*, 113 Cal.App.4th 1425, 1428, 7 Cal.Rptr.3d 427, 429 (2003). In fact, the public policy against covenants not to compete in employment contracts is so strong in California that an employee who refuses to sign such a covenant and is fired has a claim against the employer for wrongful termination. *Id.*; *D'Sa v. Playhut, Inc.*, 85 Cal.App.4th 927, 102 Cal.Rptr.2d 495 (2000).

Before 1985, the Montana Supreme Court followed California’s lead and was “less prone to enforce restrictive covenants between employer and employee than where the restriction is part of a contract for sale of a business in which goodwill may be a part of the property sold.” *J. T. Miller Co. v. Madel*, 176 Mont. 49, 52-53, 575 P.2d 1321, 1323 (1978). However, in 1985, the Court changed direction. The Court had long applied a three-part “rule of reason” test to non-compete provisions in business sales, and it now opted to apply that same rule of reason to covenants in employment contracts. *Dobbins, Deguire & Tucker, PC, v. Rutheford, MacDonald, & Olson* (1985), 218 Mont. 392, 708 P.2d 577, 580. Under the rule of reason test, a covenant not to compete is enforceable so long as:

- (1) The covenant should be limited in operation either as to time or place;
- (2) the covenant should be based on some

good consideration; and (3) the covenant should afford a reasonable protection for and not impose an unreasonable burden upon the employer, the employee or the public.

From 1985 to the present, the Court has consistently reaffirmed the *Dobbins* holding. However, over the last decade, the Court also has consistently held that all of the post-employment covenants presented to it failed to meet the test and therefore were unenforceable. See *Joseph Eve & Co. v. Allen*, 1998 MT 189, 290 Mont. 175, 964 P.2d 11; *Reier Broadcasting Co., Inc. v. Kramer*, 2003 MT 165, 316 Mont. 301, 72 P.3d 944; *Montana Mountain Products v. Curl*, 2005 MT 102, 327 Mont. 7, 112 P.3d 979; *Access Organics, Inc. v. Hernandez*, 2008 MT 4, 341 Mont. 73, 175 P.3d 899. Given that history, it is hard to conclude *Dobbins* really made a dramatic change in Montana law regarding non-competes in employment contracts.

The change really may have been more pronounced concerning non-competes in the business sale or partnership dissolution context. In more than a decade before 2009, the Court faced such a case only once and, in notable contrast to the results in cases involving post-employment covenants, it found the non-compete covenant in a stock sale agreement enforceable. *Snow Country Construction, Inc., v. Laabs*, 1999 MT 279, 296 Mont. 520, 989 P.2d 847. However, in December 2009, the Court decided *Mungas, v. Great Falls Clinic, LLP*, 2009 MT 426, where seven former partners in the Great Falls Clinic sought to invalidate non-compete provisions that reduced the buy-out they were paid when they left the partnership and then competed with it. The partners had prevailed

in the district court and recovered a summary judgment worth more than a million dollars. On appeal, the Supreme Court held the claims of five of the doctors were barred because they had signed releases, and reversed the summary judgment for the other two partners on the non-compete, saying:

In this case, unlike *Madel* and like *Dobbins*, the noncompetition covenant in question is not an absolute prohibition on the right of [the two remaining partners] to engage in their professions. But because they have chosen to practice in the proscribed area, the partnership agreements provide that they will not be paid as much. Still, they are entitled to receive a substantial amount of money for their partnership interest in the Clinic. Thus, the District Court erred in granting summary judgment in favor of [the two partners]. The question of whether the covenants not to compete are reasonable must be remanded for trial.

Id., ¶ 40. That passage is significant for three reasons.

One, the Court applied the *Dobbins* rule of reason test to this partnership agreement, the same test it applies in employee-employer agreements, and it did so without any discussion of the differences between the situations, such as the inherent disparity in bargaining power between most employers and most employees that is not true in most partnerships and business transactions, and the fact that partners and business owners have enjoyed the opportunity to build an equity interest in a business, while employees walk away from the business with nothing.

Two, while making no explicit distinction between non-competes in employment and partnership agreements, the Court highlighted that the former partners were not barred from practicing their profession in Great Falls and that they still received

substantial payments for their partnership interests, facts that are far more likely to be present in a partnership or business transaction than in an employment context. The Court did not explain how those facts were important to the *Dobbins* test, but they clearly are not relevant to the first element of the test, and the arguments under the second and third elements are not hard to imagine.

Three, the most significant aspect of the *Mungas* decision is that the case was remanded for trial on “[t]he question of whether the covenants not to compete are reasonable.” *Id.* No prior Montana case had recognized that the reasonableness of a non-compete is a factual question that should be resolved in most cases by a jury. In fact, in almost every non-compete case that came before the Court before *Mungas*, the Court either voided or validated the covenant as a matter of law, which prompted the lawyers who represented *Mungas* and other commentators to believe the issue is not triable. But based on the holding in *Mungas*, it now appears the issue cannot be decided as a matter of law unless both the facts and the way those facts fit the law are undisputed. The *Dobbins* court had simply concluded that requiring an accountant who left a firm and took clients to pay over three years, with 8% interest, a fee equal to 100% of the gross fees billed to those clients during a twelve month period “does not appear unreasonable on its face.” 708 P.2d at 579. *Mungas* suggests the trial court or the jury will have to hear evidence on matters such as the burden such a payment would place on the former employee, the amounts actually lost by the firm as a result of the employee’s breach of the covenant, and perhaps how those losses and burdens will affect clients or customers, or even the local

economy. If that proves true, then these cases will be far more difficult, interesting, and expensive than they were.

III. What Is the Court's Latest Ruling on Post-Employment Covenants?

The Montana Supreme Court's last decision regarding an employment covenant is *Access Organics, Inc. v. Hernandez*, 2008 MT 4, 341 Mont. 73, 175 P.3d 899, where the Court finally gave teeth to the second part of the *Dobbins* test: "(2) the covenant should be based on some good consideration." The Plaintiff-Employer attempted to enforce non-compete agreements against former employees who had opened a competing business, but the Court refused to enforce them because the employees had not signed the agreements until several months after they began their employment and had not received any additional consideration when they signed. The Court reversed the District Court's injunction, noting that the burden of proving an agreement does not violate the statute falls on the party seeking to enforce it, and that burden is high because Montana public policy strongly disfavors restraints on trade.

The Court said that consideration exists if an employee enters a non-compete at the time of hiring because the non-compete is a condition of employment the employee can consider in accepting or rejecting the offer, but when an employer presents an "afterthought" covenant, "the employer and employee are not on equal bargaining ground: the employee is vulnerable to heavy economic pressure to sign the agreement in order to keep his job." *Id.*, ¶ 25. Nonetheless, the Court explained (in dicta) that afterthought agreements may be valid if supported by independent consideration, such as

a raise or promotion, a specific guarantee of employment for a definite period, or access to trade secrets or other confidential information. *Id.*, ¶¶ 22 & 26.

The Court's decision is a puzzle. On one hand, in holding that Access Organics failed to meet its burden of proof to show the agreement was supported by good consideration, the Court ignored the rule that the burden of proving failure of consideration falls on the party asserting the defense. See *Larson v. Green Tree Financial Corp.*, 1999 MT 157, ¶ 25, 295 Mont. 110, 983 P.2d 357. On the other hand, by suggesting that any raise (no matter how small) or any pledge of job security (no matter how tenuous) could provide consideration for an afterthought agreement, the Court undermines its purported concern about employees being "vulnerable to heavy economic pressure to sign the agreement in order to keep [a] job." In those respects, the Court's language does not justify the result.

Regardless, the result is consistent with all of the Montana cases involving post-employment covenants not to compete over the past decade in finding some avenue for avoiding enforcement of the covenants.

- In *Montana Mountain Products v. Curl*, 2005 MT 102, ¶ 17, 327 Mont. 7, 112 P.3d 979, the Court said: "Here, based on the information in the offers of proof, Curl's only option to practice her trade in the vicinity of where she resides is to work in some way for a subcontractor of Montana Silversmiths. That, however, is exactly what her covenant not to compete prohibits. Because the covenant prohibits Curl from engaging in her profession, we conclude that it is

unreasonable and therefore an unlawful restraint on trade.” The Court chose to disregard the fact that Curl’s “trade” or “profession” was business management. She supervised people who had the special skills required to be a subcontractor for Montana Silversmiths, but she did not have those skills herself.

- In *Reier Broadcasting Company, Inc., v. Kramer*, 2003 MT 165, 316 Mont. 301, 72 P.3d 944, the Court refused to enjoin the former head football coach of the MSU Bobcats from breaching a covenant not to compete included in a four-year contract the coach had signed with a local radio station to be an announcer on a weekly “Cat Chat” program. The station agreed to pay the coach \$10,200 per year under the contract, but when MSU switched its broadcast rights to another station and directed the coach to breach his contract, the station sued to bar the coach from broadcasting for the competitor or anyone else. The station lost. Both the trial court and the Supreme Court refused the injunction based on §27-19-103(5), Mont. Code Ann., which “prohibits the use of injunctive relief to prevent a party to a personal services contract from performing services elsewhere during the life of the contract.” 2003 MT 165 at ¶19. The Court reasoned that barring the coach from working for the competitor would effectively force him to work for the station, which would amount to specific enforcement of the employment contract in violation of §27-19-103(5) and §27-1-412, which lists contracts that cannot be specifically enforced, the first of which is “an obligation to render personal service or to employ another therein.” The Court refused to enforce the contract

at the same time it said, “we do not hold that the underlying contract was invalid. The issue presented is not whether the contract is valid, but rather, whether the contract can be specifically enforced by means of an injunction. ... The issue of whether Reier has other legal remedies for the alleged breach of contract is not before the Court.” *Id.* at ¶ 20.

- In *Joseph Eve & Co. v. Allen*, 1998 MT 189, 290 Mont. 175, 964 P.2d 11, the District Court and Supreme Court both held that a covenant not to compete in an accountant’s employment agreement was enforceable, but nevertheless refused to enforce it because the plaintiff accounting firm had breached the contract by refusing to turn over client files to the former employee.

IV. What About Tortious Interference Claims Against the New Employer?

In *Curl*, the employer sued the former employee to enforce the non-compete and also sued the former employee’s new employer for interference with contractual and business relations. Noting that those claims were premised on the assumption that *Curl*’s covenant not to compete was valid, and having found that covenant void, the Court rejected the claims.

Generally, a competitor that induces or entices an employee to leave her employer in order to work for the competitor is not liable to the former employer. See generally, Annot., “Liability for Inducing Employee Not Engaged for Definite Term to Move to Competitor,” 24 ALR 3d 821, §3. However, the competitor may be liable if he has an unlawful or improper purpose, or uses unlawful or improper means. *Id.* at §4. Unlawful

or improper apparently means malicious, wholly unjustified, or untruthful. And there are cases in which a former employer can prevail on claims for tortious interference. A recent example in which the former employer recovered over \$2 million in compensatory and exemplary damages is *Nova Consulting Group, Inc., v. Engineering Consulting Services, Ltd.*, 2008 WL 3889995 (5th Cir.) (Applying Texas law).

In 2002, Conesco Finance Servicing Corporation received a jury verdict awarding \$3.5 million in compensatory damages and \$18 million in punitive damages against North American Mortgage Company in federal court in St. Louis on claims of unfair competition and unlawful interference with business expectations. Conesco claimed that North American hired away 15 branch managers from Conesco finance offices in five states, and that some of the employees wrongly took business leads. Sue Reisinger, “Unfair-Competition Claim: \$21.5M verdict for employee raid,” *National Law Journal*, April 22, 2002, p. A17. On appeal, the punitive damage award was remitted to \$7 million based on due process grounds, but the judgment was otherwise affirmed. *Conesco Finance Servicing Corp. v. North American Mortgage Co.*, 381 F.3d 811 (8th Cir. 2004).

A much older case is *American League Baseball Club v. Pasquel*, 187 Misc. 230, 63 N.Y.S.2d 537 (1946), where the New York Yankees managed to get a temporary injunction restraining the Mexican League from inducing Yankee’s baseball players to repudiate their contracts. (That case and *Reier Broadcasting* suggest a revision to an old adage; when judges try to play ball, they make bad law.)

V. What If the Covenant Discourages But Doesn’t Prevent Competition?

Many contractual clauses that get described as covenants not to compete, including the clauses at issue in *Dobbins*, *Joseph Eve*, and *Mungas*, do not prohibit competition. Instead, the clauses require a former employee or partner who competes to pay compensation to the employer for business lost as a result of the competition. Though the Montana Supreme Court has never acknowledged it, such clauses are in actuality liquidated damage provisions, and should be evaluated as such.

Until 2003, the Montana Supreme Court assessed liquidated damage provisions using the common law test under which “[t]he most important facts to be considered are whether the damages were difficult to ascertain, and whether the stipulated amount is a reasonable estimate of probable damages or is reasonably proportionate to the actual damages sustained at the time of the breach.” *Morgen v. Big Sky of Montana*, 171 Mont. 268, 273, 557 P.2d 1017, 1020 (1976), quoting *Waggoner v. Johnston*, 408 P.2d 761, 769 (Okla. 1965).

The Court unexpectedly changed the rules governing liquidated damages in *Arrowhead School District No. 75 v. Klyap*, 2003 MT 294, 318 Mont. 103, 79 P.3d 250. The Court held that “the proper way to ... analyze liquidated damages clauses [is] from the perspective of whether or not the clause is unconscionable as indicated by the nature of the bargaining process between the parties.” *Id.* at ¶48. Unconscionability focuses on two determinations: one, whether the clause is a contract of adhesion, and two, whether the contractual terms are unreasonably unfavorable to the drafter. *Id.* Making those determinations in *Arrowhead School District*, the Court held that a teacher contract

requiring the teacher to pay 20% of his salary to the school as liquidated damages if he quit after July 20 (Id. at ¶5, n. 2) was a contract of adhesion (Id. at ¶60), but was not unconscionable. (Id. at ¶72.) Though the Court applied the law of unconscionability, it considered the same facts it would have considered in applying the law of liquidated damages. Thus, it is hard to say that any real substantive change in outcomes has occurred or will occur as a result of the *Arrowhead* decision.

Likewise, while it might make sense to apply a liquidated damages analysis to provisions that penalize competition without forbidding it, the *Mungas* decision now allows parties to present the same kinds of evidence that would prove or disprove unconscionability as evidence of the reasonableness or unreasonableness of the restriction on competition. When decisions are fact-driven, the legal standard the Court applies is not all that important.

VI. What About the Doctrine of Inevitable Disclosure?

Where employers have been stymied in their efforts to enforce covenants not to compete, they have tried other approaches. One that enjoyed some recent success is the doctrine of “inevitable disclosure,” by which “a plaintiff may prove a claim of trade secret misappropriation by demonstrating that defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets.” *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995).

The Montana Supreme Court has not considered the doctrine of inevitable disclosure, but the predicates for invoking the doctrine are in place here. Montana has

adopted a version of the Uniform Trade Secrets Act, which prohibits actual or threatened misappropriation of trade secrets. §30-14-401, et seq., MCA. A trade secret is information that derives independent economic value from not being generally known or readily ascertainable to competitors and is the subject of efforts to maintain its secrecy. §30-14-402(4), MCA.

Furthermore, the Montana Supreme Court has held that an employee's duty of loyalty to the employer precludes use of information confidentially given to her or acquired by her during the course of employment. *Id.* at §§393, 394, 395, 396; *Best Dairy Farms v. Houchen*, 152 Mont. 194, 448 P.2d 158 (1968) (recognizing that confidential customer information may be protected, although information was not confidential in that case). Everything an employee acquires by virtue of the employment belongs to the employer, whether acquired lawfully or unlawfully or during or after expiration of the term of employment. §39-2-102, MCA. Of course, an employee is entitled to use the experience gained in the employment "so long as he does not violate his employer's confidence." *J.T. Miller Co. v. Madel*, 176 Mont. 49, 575 P.2d 1321 (1978) (information at issue was not confidential).

The duty not to misuse confidential information is not limited to trade secrets or items marked or stated to be confidential, but applies to information the employee should know the employer would not care to have revealed to others or to be used in competition. Restatement (Second) of Agency §395 comment b. Even after terminating employment, the employee has duties to avoid using information unfairly to his former

employer and to avoid taking advantage of continuing confidential relations created during the employment. *Id.* §396(b) & (d) and comment b; see *Jet Courier Service, Inc. v. Mulei*, 771 P.2d 486 (Colo. 1989).

To enforce such duties, courts long ago developed a doctrine of inevitable disclosure “in a series of cases involving the threatened misuse of valuable, technical trade secrets by former employees hired away by competitors seeking to gain entry into highly competitive markets.” Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and An Alternative Policy Approach*, 45 *Am. Bus. L.J.* 107, 149 (2008). That common law doctrine was expanded significantly in 1995 by the Seventh Circuit’s decision in *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995). Where prior cases had applied the doctrine only to technical knowledge, *PepsiCo* applied it to knowledge of a market and competitive business strategies, and the *PepsiCo* court did not demand evidence of bad faith or wrongful intent on the part of the former employee. Garrison & Wendt, pp. 155-56. Other courts promptly followed the lead of the Seventh Circuit. *Id.*

However, the *PepsiCo* opinion triggered scholarly criticism that the Seventh Circuit’s formulation could allow employers to circumvent employee non-compete law and thereby upset the delicate policy balance between an employee's interest in mobility and an employer's interest in protecting its proprietary information. *Id.*, p. 157. And many courts now have retreated from the broadest reading of *PepsiCo* or have rejected the doctrine outright, at least by name – although some commentators believe the

rationale behind the *PepsiCo* decision may still be influential. Id.; Gale R. Peterson, Trade Secret Law Update 2008: Including Restrictive Post-employment Covenants, *PLI 14th Annual Institute on Intellectual Property Law* 1057-62 (September-October 2008).

Should the issue arise in Montana, the courts should evaluate it by considering the same private and public interests that are evaluated in all non-compete litigation. As the Montana Supreme Court held over twenty years ago, non-disclosure agreements are governed by the same restraint of trade analysis as non-compete agreements. *State Medical Oxygen and Supply, Inc. v. American Medical Oxygen Co.*, 240 Mont. 70, 75, 782 P.2d 1272, 1275 (1989).

VII. How Do Courts Know If They Are Promoting or Stifling Competition?

Joseph Schumpeter famously identified the "process of Creative Destruction" as the "essential fact about capitalism." Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 83 (5th ed. 1976). Naturally, those capitalists who are enjoying current success in the market are not very excited about participating in a "process of creative destruction," particularly when the visible agent of that process is a highly-capable and once-trusted former employee (or partner or franchisee). And the currently-successful capitalists understandably argue that they will be less inclined to invest in new ideas and ventures if the law refuses to help them protect their investments. They see covenants not to compete, confidentiality and non-solicitation agreements, trade secret laws, and legal principles such as the doctrine of inevitable disclosure as tools to encourage investment and promote competition.

But those same covenants, agreements, laws, and legal principles are seen by others as weapons conferred on (or demanded by) the rich and the powerful in order to enlarge or extend their success and disable the process of creative destruction by discouraging budding entrepreneurs and competitors.

Both views are true, more or less, depending on the relative bargaining power of the parties, the types of trade secrets and confidential information for which protection is sought, the technical nature and maturity of the industry, the amount of investment required to enter the industry, the availability of capital to start-up businesses, and other factors. Although such factors are seldom if ever explicitly addressed in court cases, it is more than plausible that such factors play an inexplicit role in the courts' reasoning.

VIII. So What Do We Tell Our Clients?

Whatever factors are at play in the court cases, though, there is no talisman or formula by which the cases can be resolved quickly and inexpensively. Litigation between competitors under any theory of liability or defense is fact-intensive and a crap shoot.

I used to say that it probably is more difficult for a large, out-of-state employer or franchiser to enforce a covenant that puts a former employee out of work than it would be for a restaurant or other commercial tenant to enforce a covenant in a lease barring competitive or other non-conforming uses in the same commercial building, comparing *American Speedy Printing Centers, Inc. v. J & K Ventures, Inc.*, 1997 U.S. Dist. LEXIS 13269 (D. Mich. 1997)(franchiser unable to enforce facially-reasonable covenant against

former franchisee operating similar business in same location where he had operated the franchise because the franchiser was no longer competing in that geographic location, disregarding franchiser's obvious interest in finding another franchisee and resuming competition in that location) with *O'Neill v. Ferraro*, 182 Mont. 214, 596 P.2d 197 (1979)(restaurant in Bozeman hotel enforced covenant against landlord) and *Haggerty v. Gallatin County*, 221 Mont. 109, 717 P.2d 550 (1986)(ski area barred from leasing to unrelated business).

But then Judge Molloy decided *H & R Block Tax Services LLC v. Kutzman*, 681 F.Supp.2d 1248 (D. Mont. 2010), granting a preliminary injunction barring a former franchisee of H&R Block from preparing tax returns within 45 miles of her former H & R Block franchises until the case is resolved, or one year has passed. *Id.* at 1253. Judge Molloy held the non-compete provision to be a reasonable restriction on Defendant's ability to engage in her business because H & R Block had provided "training, a trade name, business methods, as well as the assurance that she would not have to compete against another business armed with the same benefits" and restricting Defendant from competing "allows the company a fair opportunity to retain its goodwill and sell the franchises without competition from the Defendant." *Id.* at 1251.

Judge Molloy also focused on the fact that "this restrictive covenant is part of a franchise agreement and not an employment agreement." *Id.* at 1252. He seems to think the distinction matters under Montana law regardless of whether the Montana Supreme Court acknowledges it. And he seems to be right. For example, the Montana Supreme

Court “blue-pencilled” a non-compete covenants in a contract for sale of a business but has never done it in an employment contract. Compare *Western Media, Inc. v. Merrick*, 224 Mont. 28, 727 P.2d 547 (1986); *Dumont v. Tucker*, 250 Mont. 417, 822 P.2d 96 (1991). Of course, no result is foreordained.

To the question of whether a particular covenant not to compete is or is not enforceable, any pat answer is wrong.