A *Wrigg*ed Game: Are Non-Compete, Non-Solicitation and Confidentiality Agreements Ever Enforceable?

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

Are Non-Compete, Non-Solicitation and Confidentiality Agreements Ever Enforceable?

By Tom Singer

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 business partner 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 an employment contract or an employee handbook, a buy-sell agreement, 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, co-owners, and franchisees 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. Early in Silicon Valley's development, some firms 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 routinely 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 noncompete 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 restriction on competition would have to present 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.

Finding experts on "knowledge structure" doesn't seem very likely or very practical in Montana, but probably isn't necessary. Montana is not a hotbed for any technology, much less cumulative technology. And the Supreme Court has never been asked to protect technology. Montana non-compete litigation isn't about protecting ideas and innovation, but almost always about protecting customer lists, and it has been between medical groups and doctors, accounting firms and accountants, radio stations and on-air personalities, manufacturers or wholesalers and salespeople and, with some frequency, insurance companies or brokerages and insurance agents.

So Gilson's analysis has not been needed here, and the Montana Supreme Court has opted for an approach closer to one proposed by Professor Kate O'Neill of the University of Washington, who argues the most important factor a court should consider when evaluating a restriction on competition "is the legitimacy of the employer's claim that it needs to restrain the employee's post-employment activities in order to preserve the value of socially desirable investments." Kate O'Neill, 'Should I Stay or Should I Go?'-Covenants Not to Compete in A Down Economy: A Proposal for Better Advocacy and Better Judicial Opinions, 6 *Hastings Bus. L.J.* 83, 86 (2010).

II. Doesn't Montana Follow California Law?

As Professors Gilson and O'Neill both note, the statutes governing restraints on trade in Montana are similar to the statutes in California (and North Dakota). Gilson, supra 613-19; O'Neill, supra 98. All were derived from the Field Code, which California adopted in 1872, and Montana adopted in 1895.

Beginning in the 1980s, California's legislature broadened the exceptions for sales of businesses and dissolutions of partnerships, so that now 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 legislature amended the statutory exception for the sale of "the goodwill of a business" in 2002 to explicitly enforce covenants against former business owners who have sold their interest, whether the entity was a corporation, partnership, or limited liability company. 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). Montana has not amended the statutory exceptions, and applies them narrowly. See, e.g., *Mungas v. Great Falls Clinic, LLP*, 2009 MT 426, ¶ 35, 354 Mont. 50, 59, 221 P.3d 1230, 1237.

Though the California legislature has expanded the business exceptions, it has not amended the broad ban on restraints of trade, and the California courts have continued to enforce it 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). Apparently, North Dakota is similarly strict in prohibiting such restrictions. O'Neill, supra 98.

For many years, Montana's "interpretation of [the restraint on trade statutes was] 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). At that time, the Montana Supreme Court 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 reiterated that covenants are enforceable if they meet the *Dobbins* standard. However, over the last fifteen years, while paying lip service to *Dobbins*, the Court has found every post-employment covenant presented to it 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; *Wrigg v. Junkermier, Clark, Campanella, Stevens, P.C.*, 2011 MT 290, 362 Mont. 496, 265 P.3d 646.

The Court always has been kinder to non-compete covenants in business agreements than in employment agreements. A year after it decided *Dobbins*, the Court "blue-pencilled" a non-compete covenant in a contract for sale of a radio station. *Western Media, Inc. v. Merrick*, 224 Mont. 28, 727 P.2d 547 (1986). Five years later, the Court blue-pencilled a non-compete in contract to purchase an accounting practice. *Dumont v. Tucker*, 250 Mont. 417, 822 P.2d 96 (1991). The next time the Court faced a non-compete in a business contract (a stock sale agreement) was 1999, and the Court enforced it. *Snow Country Construction, Inc., v. Laabs*, 1999 MT 279, 296 Mont. 520, 989 P.2d 847. And when a business non-compete came before the Court again, ten years later, the Court surprised the plaintiffs by reversing a summary judgment order that had relied on *Dobbins*. *Mungas, v. Great Falls Clinic, LLP,* 2009 MT 426, 354 Mont. 50, 221 P.3d 1230. The Court remanded the case for trial.

Mungas merits further attention. In *Mungas*, 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 seven 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 highlights several differences between Montana law and California law governing non-competes.

One, the Court purported to apply the same test to a partnership agreement as it would to an employment contract, whereas California applies different standards. But two, while California simply refuses to enforce any non-compete in an employment contract, the Court in *Mungas* said enforceability is an issue of fact. The Court remanded for trial on "[t]he question of whether the covenants not to compete are reasonable." Id. The lawyers for Mungas had argued that prior cases had always voided or validated covenants as a matter of law, so the issue was not triable. But *Mungas* held the issue could not be decided as a matter of law, at least in that case, apparently because the former partners were not barred from practicing their profession in Great Falls and had received substantial payments for their partnership interests.

Unfortunately, the Court said nothing about what kind of evidence might be admissible on the issue of reasonableness or how the jury might be instructed. So *Mungas* suggested parties in non-compete litigation not only were unlikely to get summary judgment, but also would go to trial knowing little about how the case would be evaluated on appeal. The prospects for relatively quick and inexpensive resolution of non-compete cases seemed to fade, and it didn't seem to matter whether the context was partnership or employment.

III. Is There A Pattern in the Court's Rulings on Post-Employment Covenants?

As noted above, in five cases decided over the last fifteen years the Montana Court has paid lip service to *Dobbins* and the enforeability of "reasonable" non-compete provisions in employment agreements while always finding some reason to refuse enforcement. Before focusing on the most recent case, *Wrigg*, a brief review of the four earlier cases is instructive.

- 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 agreement by refusing to turn over client files to the former employee.

- In *Reier Broadcasting Company, Inc., v. Kramer*, 2003 MT 165, 316 Mont. 301, 72 P.3d 944, the Court refused to enjoin the head football coach of the MSU Bobcats from taking his "Cat Chat" program to a different radio station, even though he was violating a non-compete in his four-year employment agreement. The station had paid him $10,200 per year to host "Cat Chat," but then MSU switched its broadcast rights to another station and directed the coach to breach his contract. The station asked the court to bar the coach from broadcasting for any other station. The Court refused, reasoning that barring the coach from working for other stations would amount to specific enforcement of the employment contract, which is prohibited by §27-19-103(5) and §27-1-412. The Court refused to grant an injunction to enforce the contract, but it did not hold the underlying contract 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 *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.

- *Access Organics v. Hernandez* held the employer had failed to meet its burden of proof to show the agreement was supported by good consideration, ignoring the rule that the party asserting a defense bears the burden of proof. See *Larson v. Green Tree Financial Corp.*, 1999 MT 157, ¶ 25, 295 Mont. 110, 983 P.2d 357. But the Court also suggested that any raise (no matter how small) or any pledge of job security (no matter how tenuous) could have provided consideration for an afterthought agreement, which gives short shrift to the Court's expressed concern about employees being "vulnerable to heavy economic pressure to sign the agreement in order to keep [a] job."

Following the Court's pattern of refusing to enforce the covenants, the Court invalidated another covenant not to compete last November in *Wrigg v. JCCS*. Wrigg had been employed by JCCS as an accountant for 20 years, and had been a shareholder since 2003. She signed several a number of employment agreements, all containing non-compete provisions. In May 2009, JCCS notified Wrigg that her employment would end when her contract expired on June 30, 2009. She sued JCCS asking for a judgment declaring the non-compete covenant unenforceable. The trial court rejected her claim and ruled in favor of JCCS. The Supreme Court reversed and remanded with directions to enter judgment for Wrigg. The Court found the covenant unenforceable because JCCS had "terminated" Wrigg without cause and thereby conceded no legitimate business interest had been served by the termination.

The Court's holding ignored evidence JCCS had presented (and the trial court apparently credited) showing JCCS chose not to renew Wrigg's employment agreement because of the dysfunction she had created in the office. The Court also attached no significance to the fact that Wrigg was not terminated at all, thereby suggesting that employers have some obligation to renew employment contracts for specific terms when they expire (a notion that is hard to reconcile with the Wrongful Discharge Act).

At least one attorney reads the *Wrigg* decision to make it "even clearer" that covenants not to compete can be enforced by employers, except when they terminate an employee without cause. See "Court: Fired CPA may keep old clients," *Helena Independent Record*, November 30, 2011. I don't see it that way. As hard as the Court worked to strike down the covenant in *Wrigg* (and *Curl* and the other cases), I think we have to take the Court very seriously when it says

"Montana law strongly disfavors covenants not to compete," at least in the context of employment.

IV. What If the Covenant Discourages But Doesn't Prohibit Competition?

Many contractual clauses that have been described as covenants not to compete, including the clauses at issue in *Dobbins, Joseph Eve, Mungas,* and *Wrigg*, really do not prohibit competition. Instead, the clauses require a former employee or partner or shareholder 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. Perhaps they 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.

Mungas and *Wrigg* certainly opened the door to evidence concerning good will, trade secrets, and customer relationships, but probably also to other matters relevant to reasonableness, such as the relative bargaining power of the parties, the social desirabililty of the employer's business, and the necessity of restraining the employee's post-employment activities in order to preserve the value of that business investment. See O'Neill, supra. Whether that evidence comes in to prove or disprove unconscionability or the reasonableness of a restriction on competition may not matter. When decisions are fact-driven, the legal standard the Court applies is not all that important.

V. 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 outside Montana in which a former employer has prevailed on claims for tortious interference. One 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).

Another example - in 2002, Conseco 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 North American had 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. *Conseco 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.

VI. What Is the Doctrine of Inevitable Disclosure?

When employers have been stymied in their efforts to enforce covenants not to compete, they have tried other approaches. One that enjoyed some success for a time 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). In Montana, 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 "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 quite narrow until it was expanded significantly 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, critics noted 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 are likely to evaluate it by applying the *Dobbins* standard and considering the same kinds of private and public interests that have been evaluated in other litigation over restraints on trade. See *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 "essential fact about capitalism" to be the "process of Creative Destruction." 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, business 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 shackles the rich and the powerful use to discourage budding entrepreneurs and competitors.

Both views have an element of truth. Of course, slavery has been abolished. But the job market can be brutal, and the legal system buffers the brutality in many ways. The Montana Supreme Court’s recent decisions in this area encourage trial courts to consider whether the business interests claimed by the employer are legitimate and how much of a restriction a covenant actually imposes on the employee. The Court may also be open to considering factors such as 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. Considering such factors may be a good thing for parties because cases may be decided based on facts rather than a judge’s knee-jerk reaction to the word “non-compete.” Unfortunately, considering those factors may also be a good thing for lawyers because it will make litigation longer and more expensive.

VIII. So What Do We Tell Our Clients?

Whatever factors are at play in the court cases, 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 it would be easier for a restaurant or other commercial tenant to enforce a covenant in a lease than for a large, out-of-state franchiser to enforce a covenant that puts a former franchisee out of work, and I would compare *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), with *American Speedy Printing Centers, Inc. v. J & K Ventures, Inc.*, 1997 U.S. Dist. LEXIS 13269 (D. Mich. 1997)(holding franchiser could not enforce facially-reasonable covenant against former franchisee who was operating a similar business in the same location where he had operated the franchise).

But then Judge Molloy granted a preliminary injunction in *H & R Block Tax Services LLC v. Kutzman*, 681 F.Supp.2d 1248 (D. Mont. 2010), barring a former franchisee of H&R Block from preparing tax returns within 45 miles of her former H & R Block franchises. 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, of course, comparing cases like *Mungas* and *Wrigg* suggests he is right. Of course, no result is foreordained.

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