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Sign This Agreement Not to Compete or You're Fired! Noncompete Agreements and the Public Policy Exception to Employment at Will

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A California jury recently awarded an employee who was fired for refusing to sign a noncompete agreement $1.2 million in damages for wrongful discharge. Whether employees have a right to refuse to sign unenforceable noncompete agreements is an emerging employment law issue. This article considers whether a wrongful discharge remedy is available in such cases under the public policy exception to the employment-at-will doctrine. State court decisions addressing the question are conflicting. Some courts have allowed employers to discharge employees who refuse to sign a noncompete agreement even if the agreement is unreasonable. Other courts have recognized a claim for damages under the public policy exception. This article explores the issue from policy and managerial perspectives, critically analyzing the policy justifications advanced by the courts in those decisions, and comments on the liability risks to employers and the proper resolution of the issue.

KEY WORDS: wrongful discharge; noncompete agreement; employment at will; public policy exception.

Consider the following scenario: Alicia has worked for ABC Insurance for 5 years. She has performed well and advanced in the company to the position of Account Manager for the region. After ABC is acquired by XYZ Insurance in a hostile takeover, the CEO of XYZ mandates that all key personnel sign a confidentiality and noncompetition agreement. Alicia is presented with the agreement, and after a review of its terms, she becomes concerned about the broad scope of the noncompete clause. It prohibits her from working for any competitor anywhere in the United States for a period of 2 years after she leaves XYZ. She has been contacted from time to time by colleagues at other firms in the industry about coming to work for their companies, but happy with her job and the company, she has always politely declined their invitations. However, given the merger and the new management team, she is reconsidering her options.

She discusses the agreement with her immediate supervisor who informs her that the company policy requiring the confidentiality and noncompetition agreement is designed

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to protect the trade secrets of XYZ. He concedes to Alicia that she has limited or no access to trade secrets, but tells her that all key persons must sign the agreement or be terminated. She believes that the noncompete agreement is unfair and that the real reason for the policy is to prevent "cherry picking" (i.e., to prevent competitors from hiring away experienced employees who might be inclined to leave XYZ because of the merger).

She calls a friend who is a local employment law attorney to get some legal advice. He advises her that the company probably cannot enforce the agreement because it is unreasonable both in terms of time and scope. However, he warns her that if she signs it and leaves the company, XYZ may bring a lawsuit to enforce the agreement by way of an injunction, a lawsuit that she will have to vigorously defend. Moreover, it is possible that competitors of XYZ will be reluctant to hire her during the noncompete period for fear of a lawsuit based on intentional interference with XYZ's employment relationships. The attorney is not sure whether she has any recourse if she is fired for refusing to sign the agreement, noting that she is an at-will employee and thus can ordinarily be terminated without cause. Alicia refuses to sign the agreement and is fired. Does she have a viable claim for wrongful discharge?

This paper examines the issue presented in the above scenario: whether an employee who is terminated for refusing to sign an unlawful agreement not to compete can sue his or her employer for wrongful discharge under the public policy exception to employment at will. Employers are increasingly using agreements not to compete, particularly in the high tech sector of the economy, to protect trade secrets and customer relationships (LaVan, 2000). Although such restrictive covenants are designed to prevent unfair competition by former employees, noncompete agreements have negative societal effects, not only on the freedom and mobility of employees, but also on competition and technological advancement in the marketplace. As courts continue to refine the law of wrongful discharge and weigh the balance between the interests of employers in managerial flexibility and the concerns of employees in fair treatment, the issue of whether employers should be able to fire an employee for refusing to sign an illegal noncompete agreement will continue to emerge as an important policy question.

The few cases that have addressed the issue have reached contrary conclusions. Some courts have opted for a predictable, proemployer approach to the issue, holding that an employer can discharge an employee who refuses to sign an agreement not to compete even if the agreement is unreasonable and unenforceable. In contrast, other courts have allowed wrongful discharge suits under the public policy exception to employment at will if the particular agreement is unenforceable. A proper analysis of the issue requires an examination of the public policy exception and the law of employee noncompete agreements. First, the employment-at-will doctrine and the exceptions to that entrenched doctrine, particularly the public policy exception are reviewed. Second, agreements not to compete in the employment context, including the different approaches states have developed to determine the enforceability of such restrictive covenants are discussed. Third cases from Oregon, Vermont, and Wisconsin that have allowed employers to fire employees who refuse to sign unenforceable agreements not to compete are analyzed. Finally, decisions from California allowing employees who were terminated for refusing to sign unenforceable agreements not to compete to sue their past employers for wrongful discharge are explored. We conclude with a policy analysis of the issue, including managerial implications.

EMPLOYMENT AT WILL AND THE PUBLIC POLICY EXCEPTION

Under early English common law, the period of an indefinite term employment contract was presumed to be 1 year, just cause being required for termination prior to the end of the term (Feinman, 1976). However, U.S. courts rejected the English approach in favor of a contrary rule—the employment-at-will doctrine. Under this doctrine, when employment is for an indefinite term, either party may terminate the employment relationship "for good cause, for no cause, or even for cause morally wrong, without being thereby guilty of legal wrong" (*Payne v. Western & A.R.R.*, 1884). Although some commentators (cf. Feinman,1976), trace the origin of the employment-at-will doctrine to Wood's master–servant treatise (Wood, 1877), other scholars contend that the employment-at-will rule has always been a fixture of U.S. common law (cf. Ballam, 1995). Regardless of its origins, the at-will rule was widely accepted by the time of the industrial revolution, and has now become a well-established bedrock principle of employment law in most states.

The traditional employment-at-will doctrine permits the termination of indefinite term employment by either party at any time for any reason without liability for damages. Although some authors view the employment-at-will doctrine as favoring employers over employees (cf. Blades, 1967), from a policy standpoint, the doctrine is considered fair to both employers and employees and necessary in a modern marketplace economy.

> [T]he employment-at-will rule serves the interests of employees as well as employers. It works to the employees' advantage to have an at-will contract that allows them to leave their employers at any time for any reason. An employment contract with a specific term could lock an employee into a disadvantageous relationship. The at-will doctrine provides employees and employers with much needed flexibility to fashion their own relations in a vibrant economy. It is a practical manifestation of our nation's values such as freedom of movement and entrepreneurial spirit. And it provides employees with the means to take control of their livelihoods. (*Mackenzie v. Miller Brewing Co.*, 2001, pp. 742–743)

Blades (1967), in his seminal article on the employment-at-will doctrine argued for the creation of a legal claim for abusive discharge of an employee. And the courts have, over time, created exceptions to the absolute right of an employer to terminate an at-will employee to prevent such abusive discharges by employers. Today, courts recognize a claim for wrongful discharge under these exceptions to the employment-at-will doctrine. Currently, depending on the state, the doctrine may be subject to one or more of three exceptions: (1) the covenant of good faith and fair dealing, (2) the implied contract theory and (3) wrongful discharge in violation of public policy. A recent analysis of state court decisions found that the implied contract theory was recognized in 38 states (including the District of Columbia), the good faith and fair dealing covenant in 11 states, and the public policy exception in 43 states (including the District of Columbia; Muhl, 2001). A brief discussion of the first two exceptions follows, along with a more detailed discussion of the public policy exception.

Covenant of Good Faith and Fair Dealing

The least recognized exception to the employment-at-will doctrine is the good faith and fair dealing exception under which a covenant of good faith is implied in every employment contract. This exception has been recognized by court decision in a small minority of states and by statute in Montana (*Mont. Code Ann*, 2002). Under this covenant, employers may not terminate an employee for a reason that a court deems to be in bad faith or for bad cause. Thus, despite being the least recognized exception,

> the exception for a covenant of good faith and fair dealing represents the most significant departure from the traditional employment-at-will doctrine. Rather than narrowly prohibiting terminations based on public policy or an implied contract, this exception—at its broadest—reads a covenant of good faith and fair dealing into *every* employment relationship. It has been interpreted to mean either that employer personnel decisions are subject to a "just cause" standard or that terminations made in bad faith or motivated by malice are prohibited. (Muhl, 2001, p. 10)

Implied Contract Theory

Rather than imply a covenant of good faith in every contract, most states recognize that an at-will employment relationship may be subject to an implied agreement limiting the employer's discretion to terminate the employee. This implied contract is typically based on oral or written representations to an employee that the employment relationship is not a strictly at-will relationship or that terminations are subject to certain standards or processes. Such representations may be statements made in employee handbooks or other written employment materials (cf. *Toussaint v. Blue Cross & Blue Shield of Michigan*, 1980) or oral promises made to the employee (cf. *Berube v. Fashion Centre Ltd.*, 1989). Currently, 38 states find that such representations may limit the employer's legal right to terminate an employee without just cause. However, it has been noted that the significance of this exception has diminished in recent years "because of employers' attempts to state clearly, usually in the contract if there is one as well as in a prominent location in the employee handbook, that the employment relationship is an at-will relationship" (Ballam, 2000, p. 655). Such *express* disclaimers are generally effective to eliminate any *implied* term limiting the employer's right to terminate without cause.

Public Policy Exception

The public policy exception is the most common exception (recognized in 43 states) to the employment-at-will doctrine and is the exception most relevant to this article. Under this exception, an at-will employee has a cause of action against his or her employer when a termination contravenes a public policy of the state. The exception had its genesis in the California case of *Petermann v. International Brotherhood of Teamsters Local 396* (1959). Petermann was an at-will employee who refused to follow his employer's request that he commit perjury. He was subsequently terminated by his employer. He maintained that because perjury is a criminal act, allowing an employer to terminate an employee for refusing to commit a criminal act is a violation of public policy. In accepting his assertion, the California Supreme Court stated: "To hold that one's continued employment could be made contingent upon his commission of a felonious act at the insistence of his employer would be to encourage criminal conduct upon the part of both employee and employer and would serve to contaminate the honest administration of public affairs. This is patently contrary to the public welfare." Petermann established the theoretical basis for the public policy exception, and eventually most jurisdictions followed its lead and adopted the exception.

Claims for wrongful discharge in violation of public policy generally fall into four categories (Ballam, 2000). First, courts have permitted suit where the employee is discharged for refusing to commit an illegal act, as in *Petermann*. Second, when an employee is fired for exercising an employment-related right or privilege (e.g., filing a workers' compensation claim), a wrongful discharge claim is viable. Third, many states allow a suit for wrongful discharge when an employee is terminated for performing a public duty (e.g., jury duty). Finally, some states recognize a claim where an employee is discharged for reporting employer wrongdoing (whistleblowing cases).

Nonrecognition

Despite its widespread adoption, eight states still do not recognize the public policy exception. The primary justification is that the creation of a public-policy-based exception to employment at will should be left to the legislative branch, and the courts should not assume the role of articulating public policy. The recent Georgia case of *Eckhardt v. Yerkes Regional Primate Center* (2002) serves to illustrate. In that case, Bonnie Eckhardt and Bridget Mueller maintained that they were terminated from employment with Yerkes Regional Primate Center because they documented and internally reported a procedure for transferring infected macaque monkeys that presented a significant public health risk. Eckhardt and Mueller maintained that because they were whistleblowers, their termination violated the public policy of the state. The Georgia Court of Appeals would not accept the public policy exception and noted

> [t]he courts of this state have consistently held that they will not usurp the legislative function and, under the rubric that they are the propounders of "public policy," undertake to create exceptions to the legal proposition that there can be no recovery in tort for the alleged "wrongful" termination of the employment of an at-will employee. That courts of other jurisdictions may have done so is of no consequence. . . .

As the Georgia court noted, courts in other jurisdictions have been willing to develop a public-policy-based exception to the employment-at-will doctrine. These jurisdictions have come to be viewed as applying either a narrow or broad public policy exception.

Narrow Exception

States that have adopted a narrow public policy exception require the termination to violate public policy grounded in either a statutory or constitutional provision. Specifically, these states insist upon "the existence of a statute [or constitutional provision] that either specifically required the action or specifically granted the right to do the action for which the employee was fired" (Ballam, 2000, p. 662). The Wisconsin Supreme Court's opinion in *Brockmeyer v. Dun & Bradstreet* (1983) is illustrative. Brockmeyer maintained that he was terminated for refusing to help Dun & Bradstreet prepare a defense to a sex discrimination lawsuit and for indicating that he would tell the truth if called to testify. In its opinion, the Supreme Court of Wisconsin stated

> A wrongful discharge is actionable when the termination clearly contravenes the public welfare and gravely violates paramount requirements of public interest. The public policy must be evidenced by a constitutional or statutory provision. An employee cannot be fired for refusing to violate the constitution or a statute. . . . No employer should be subject to suit merely because a discharged employee's conduct was praiseworthy or because the public may have derived some benefit from it.

Under this narrow formulation of the public policy exception, Brockmeyer failed to establish a wrongful discharge.

Broad Exception

While most states that recognize the public policy exception do so narrowly, 16 states have adopted a broader exception (Walsh & Schwarz, 1996). These jurisdictions have expanded the public policy exception to include terminations in violation of administrative regulations and that undermine notions of public good and civic duty.

For example, in *Greene v. Ralee Engineering Co.* (1998), Green filed a wrongful discharge claim against Ralee Engineering. He maintained that he was terminated in retaliation for reporting to his supervisors that the company was shipping parts that had failed company inspection. He maintained that this termination violated the public policy of aviation safety as found in Federal Aviation Administration (FAA) regulations that promote aviation safety. Green did not provide any specific statute or regulation that was being violated by his employer. Also, Ralee asserted that they had not violated a specific statutory or constitutional provision and further contended that FAA safety regulations did not apply to the manufacturer of aircraft component parts. The California Supreme Court held that administrative regulations can be the basis for a wrongful discharge claim under the public policy exception. Furthermore, the court held that "administrative regulations that are grounded in a statute reflecting a fundamental public policy (i.e., airline safety) could provide the public policy basis for wrongful discharge *even though* those regulations do not specifically apply to the employer." Therefore, opinions like *Green* expand the public policy exception to include regulatory violations.

Another case that illustrates the broad view that some courts apply to the public policy exception is *Palmateer v. International Harvester Co*. (1981). Palmateer maintained that International Harvester terminated him after he provided information to law enforcement personnel about alleged criminal acts by a coworker and agreed to help them during any criminal investigation and trial. Nothing in the Illinois constitution or statutes required employees to report the potential criminal activity of a coworker. However, "the court found that public policy favored citizen crime fighters and the exposure of criminal activity. Thus, Palmateer brought an actionable claim for retaliatory discharge." This case demonstrates the extension of the public policy exception to judicially created notions of public policy.

In summary, a majority of states accept the public policy exception, although the breadth of the exception varies widely among the states. While most states require a termination in violation of a specific statutory or constitutional provision, other states take a much broader view of public policy. Whether a wrongful discharge claim for refusing to sign a noncompete agreement is viable will depend in part on whether the court takes a broad or a narrow view of the public policy exception. It also will depend on the law of employee noncompete agreements, which is discussed in the next part of the article.

AGREEMENTS NOT TO COMPETE IN THE EMPLOYMENT CONTEXT

The common law prohibited the enforcement of "naked" agreements not to compete where the sole purpose of the agreement was to restrict free and fair competition. As restraints on free trade, such agreements were considered contrary to public policy (*United States v. Addyston Pipe & Steel Co.*, 1898). Modern antitrust laws codify this common law approach to restraints on trade and provide additional remedies and new regulatory processes to prevent anticompetitive agreements and abuses of market power.

Despite the common law abhorrence of trade restraints, reasonable agreements not to compete ancillary to a legitimate agreement were permitted if they served business interests other than restricting competition. Noncompete agreements ancillary to the sale of a business and restrictive covenants that are part of an employment contract are the two most common situations in which such agreements are enforceable. Additionally, courts have allowed noncompete agreements that are ancillary to a business relationship or commercial transaction, including, for example, noncompete clauses in licensing agreements and in commercial leases (*DAR & Associates, Inc. v. Uniforce Services, Inc.*, 1999).

Agreements not to compete in the employment context are primarily designed to protect two interests of the employer: the goodwill interest of the business and its trade secrets and other non-public proprietary information (Blake, 1960). As with a noncompete agreement in connection with a sale of a business, which is designed to protect the goodwill purchased by the buyer, an employee noncompete agreement is often an attempt to prevent an employee from taking advantage of the goodwill of the business generated by the employee in his or her dealings and relationships with customers of the business (Leibman & Nathan, 1987). This customer goodwill, although developed by the employee, is an asset of the business, and it may be unfair for a former employee to use his contacts and knowledge of the market to solicit or do business with former customers or clients of the business. Thus, agreements not to compete are designed in part to prevent a form of unfair competition.

Protecting trade secrets and other proprietary business information is the second most common justification for employee restrictive covenants. Although past employees are under a continuing duty not to disclose or use trade secrets of their prior employers, and employers can secure an injunction to prevent such use (or the imminent threat of it), agreements not to compete are utilized as a prophylactic or preventative measure (Blake, 1960). That is, they are designed to minimize the potential for trade secret misappropriation by preventing an employee from working for a competitor or engaging in a competing enterprise (Leibman & Nathan, 1987). Also, by using restrictive covenants, employers avoid the difficulties of proving an actual or threatened misappropriation of trade secrets so as to secure an injunction. Additionally, they are often able to prevent any misappropriation before it occurs rather than responding to a violation where the damages (that may be irreparable) from trade secret disclosure have already occurred (Blake, 1960). Thus, employee noncompete agreements are designed to prevent the *potential* for unfair competition through a misappropriation of trade secrets by a former employee.

Allied against these substantial employer interests are the interests of employees in mobility and the interests of the public in free competition. Restrictive covenants may impose a substantial burden on employees by depriving them of an opportunity for personal growth and professional advancement. In a modern, rapidly changing work environment, where technological knowledge and informational advantages are important attributes, an individual deprived of the ability to work in his or her field or profession, even for a short period of time, pays a heavy price and may be placed at a significant disadvantage in terms of marketability (cf. *EarthWeb, Inc. v. Schlack*, 2000). There also is the risk of overreaching.

Employers will naturally use their superior bargaining position to impose as burdensome a noncompetition agreement as possible, not only to protect their legitimate goodwill and proprietary business interests, but also to shield themselves from competition—competition that can come from other companies the employee may go to work for or from the employee who may establish a new competing business (Blake, 1960). Society has an interest in preventing overly restrictive noncompetition agreements, not only to protect employees from unreasonable restraints that may be a product of unfair bargaining position, but also to protect the public from the effects of agreements that stifle competition and new innovations and developments in the market.

The law of employee agreements not to compete reflects the competing interests of employers, employees, and of the public, with most states adopting an approach that attempts to balance these conflicting concerns (Blake, 1960). Despite differences that exist from state to state, there are some generally accepted principles that courts follow in judging the enforceability of an employee noncompete agreement. Because of the superior bargaining position of the employer, and the negative impact restrictive covenants have on employees, employee noncompete agreements are disfavored by the courts (cf. *Kallok v. Medtronic, Inc.*, 1998). This judicial suspicion of such agreements results in a probing examination of the terms of noncompetes, a form of judicial scrutiny stricter than that employed in the sale-of-business context (cf. *Gary Van Zeeland Talent, Inc. v. Sandas*, 1978). Although a consideration of the facts surrounding an agreement not to compete is essential for a determination of its enforceability, courts consider the enforceability issue to be a question of law to be determined by the courts (cf. *Orkin Exterminating Co. v. Walker*, 1983). In effect, employee agreements not to compete are presumed to be unenforceable, the burden on the employer to justify the need for and the reasonableness of the terms of the agreement. Some states have statutory regulations on agreements not to compete, but most states have left the balance of competing interests to the courts as a matter of common law. Whether controlled by statute or common law, states have adopted different approaches to the enforceability of restrictive covenants in employment contracts. Some wholly ban or severely limit the circumstances under which an employee noncompete agreement will be enforced while others allow such agreements to protect a wide array of employer interests. Most adopt the common law approach that takes into consideration the reasonableness of (1) the time period of the noncompete agreement, (2) the geographic area covered by it, and (3) the business activities restricted by the covenant. However, among the states, there are significant variations regarding the nature of the interests an employer has to establish to justify a noncompete agreement, the extent to which the agreement can restrict an employee's rights, the need for consideration to support the agreement, and the enforceability of overbroad agreements.

Restrictive State Laws

A minority of jurisdictions take a restrictive approach that prohibits or severely limits the circumstances under which an employee noncompete is enforceable. Most commonly, such limitations are imposed by statute. For example, California (*Cal. Bus. & Prof. Code*, 2002) and North Dakota (*N. D. Cent. Code*, 2002) prohibit agreements not to compete in connection with an employment relationship. Oklahoma's statute allows only one type of noncompete agreement, a nonsolicitation agreement preventing a former employee from "directly" soliciting the goods or services from the established customers of the employer's business (*Okla. Stat. tit.*, 2002). Louisiana has a statute that restricts employee noncompete agreements in two ways (*La. Rev. Stat. Ann.*, 2002). First, the restrictive covenant can only prevent an employee from engaging in a competing enterprise or soliciting old customers of the business. Second, the geographic reach of the noncompete agreement must be limited to a specific county or city. The Louisiana Supreme Court recently interpreted its statute, further limiting the reach of employee noncompete agreements. In *SWAT 24 Shreveport Bossier, Inc. v. Bond* (2001), the court had to interpret language in the statute providing that an employee "may agree with his employer to refrain from carrying on or engaging in a business similar to that of the employer and/or from soliciting customers of the employer." The issue was whether the language regarding "carrying on or engaging in" a business allowed a restrictive covenant that precluded an employee from going to work for a competitor as well as setting up a competing business. The covenant in *SWAT 24* prohibited the employee from "directly or indirectly" competing with the business or serving as an employee of a competing business. The court interpreted the phrase to mean that the employee may agree to refrain from carrying on or engaging in his *own* business, and thus the employee noncompete in *SWAT 24* was overbroad and unenforceable.

Although severe limits on noncompete agreements in employment contracts are generally statutory in nature, some states have limited such agreements through common law doctrines. Texas is an example. In recent years, the state's supreme court and legislature have had an ongoing battle over employee agreements not to compete. Traditionally, Texas followed the common law reasonableness approach, but in *Hill v. Mobile Auto Trim, Inc.* (1987), the Texas Supreme Court adopted the so-called "common calling" test. This new test prohibited agreements not to compete that limited competition in a "common calling," an ambiguous phrase that was intended to ensure that there was adequate consideration for the restrictive covenant.

In response, the Texas legislature passed the Covenants Not to Compete Act (*Tex. Bus. Com. Code Ann*., 2002a), that allowed an employee noncompete agreement ancillary to an "otherwise enforceable agreement" so long as it was reasonable in terms of time, area, and scope of business activity. Despite the apparent return to the common law under the statute, the Texas court in *Travel Masters, Inc. v. Star Tours, Inc.* (1991) subsequently limited the ability of employers to impose restrictive covenants by holding that an at-will employment relationship could not support an employee's agreement not to compete.

In response, the legislature modified the statute to overrule the court's interpretation of the "otherwise enforceable agreement" language. Subsequent to the amendment of the statute, however, the Texas Supreme Court in *Light v. Centel Cellular Co.* (1994) fashioned new requirements for an employee restrictive covenant to be enforceable. The *Centel Cellular* test to determine whether an agreement is ancillary to an at-will employment relationship is twofold. First, the consideration given by the employer in the agreement must *give rise* to the employer's interest in restraining the employee from competing. Second, the restrictive covenant must be designed to enforce the employee's consideration or return promise in the agreement. Thus, if an employee is given proprietary business information agreeing not to disclose that information, and signs an agreement not to compete, the restrictive covenant is ancillary to that nondisclosure agreement. If, on the other hand, an at-will employee who has already been given access to trade secrets is requested to sign a restrictive covenant, it is probably not ancillary to any otherwise enforceable agreement. Thus, despite the efforts of the Texas legislature, judicially created doctrines make it difficult to enforce an employee agreement not to compete in the state.

Protectible Interests

In most states, agreements not to compete are subject to some variation of the common law reasonableness standard. Under this standard, the threshold requirement is whether the agreement not to compete is necessary to protect some legitimate interest of the employer. Although trade secrets and customer goodwill are the interests most often claimed by employers, states differ in terms of the extent to which proprietary business information and customer goodwill will be considered a protectible interest. Illinois, for example, recognizes an employer's interest in customers as protectible only if the customer relationships are "near-permanent" and the employee would not have had contact with the customers "but for" his or her employment (cf. *American Claims Service, Ltd. v. Boris,* 1985).

To determine whether a near-permanent relationship exists, the Illinois courts consider seven factors; (1) the number of years the employer needs to develop its clientele; (2) the money invested to develop its clientele; (3) the difficulty involved in developing the clientele; (4) the extent of personal customer contact by the employee; (5) the employer's degree of knowledge of its customers; (6) the time the customers have been associated with the employer; and (7) the continuity of relationships between the employer and its customers (*McRand, Inc. v. Van Beelen*, 1985). This near-permanent relationship requirement precludes the enforcement of restrictive covenants where the customer relationships are short term or the customer contacts would have been established regardless of the employment relationship.

In New York, the Court of Appeals has limited the legitimate interests in customer relationships to the protection of employers from competition by former employees whose skills or services are "unique or extraordinary." Whether an employee provides unique or extraordinary skills does not depend upon the value of the employee to the organization or the employee's position with or knowledge level of the business. Rather, it depends upon the unique skills or abilities of the employee. Although members of professions have generally been considered to provide unique or extraordinary services, and subject to broader restrictions, the Court of Appeals has declined to extend that general rule to all professional employees. In the recent case of *BDO Seidman v. Hirshberg* (1999), the court refused to assume that a manager of an accounting firm provided unique or extraordinary skills, concluding that his employment was not based on any unique accounting services he provided to clients. This determination required the court to closely scrutinize the legitimate interests that BDO had in imposing a restrictive covenant on the manager. It found that the only legitimate interest was in protecting against the "competitive use of client relationships which BDO enabled him to acquire through his performance of accounting services for the firm's clientele." By limiting the protectible interest in this fashion, the court found the restrictive covenant overbroad because it extended to BDO's entire client base.

States also differ in terms of whether expenses incurred in training or educating new employees are a legitimate justification for imposing an agreement not to compete. By statute, Colorado law on noncompetes allows a contractual provision for the "recovery of the expense of educating and training an employee who has served an employer for a period of less than two years (*Colo. Rev. Stat.*, 2002)." The Florida noncompete statute specifically provides that "legitimate business interest" includes "extraordinary or specialized training (*Fla. Stat. Ch.*, 2002a)." Training or education that can be acquired by self-study or in the ordinary course of working for a business is not considered extraordinary (*Hapney v. Central Garage, Inc.*, 1991). The idea underlying the extraordinary training interest is that if an employer has expended resources to provide an employee with some unique skills, then it would be unfair for that employee to use those skills to compete with his former employer. In line with Florida's "extraordinary" requirement relating to education expenses, the New Hampshire Supreme Court recently rejected the contention that costs associated with recruiting and hiring employees is a legitimate interest justifying an employee noncompete agreement. In *National Employment Service Corporation v. Olsten Staffing Service, Inc.* (2000), the legitimacy of the employee noncompete agreements arose in a lawsuit for intentional interference with a contract between two businesses engaged in supplying temporary workers to industry. National's employees were not allowed to accept employment at a "client company" (a temporary employer) for a period of 90 days after termination. The court rejected National's assertion that its noncompete agreements served legitimate interests: [T]he sole "employer interest" articulated by National is the retention of employees for a sufficient period to enable it to recoup costs associated with "recruiting, interviewing, checking references, qualifying, insuring, and placing" its employees. All businesses, however, incur expenses in recruiting and hiring employees . . . Postemployment restrictions on such employees would be contrary to public policy and would impose an undue hardship, particularly for at-will employees who could be discharged at any time."

Breadth of Restrictive Covenants

A noncompete agreement cannot be broader than reasonably necessary to protect the legitimate interests of the employer. In addition to time and geographic scope, the breadth of the noncompetition agreement in terms of the activities that the former employee cannot engage in is carefully scrutinized by the courts. Some courts take a strict view of the interest in goodwill, distinguishing between ordinary competition from a former employee and methods of "unfair competition," limiting the scope of noncompete agreements to competition that would be unfair. So, for example, many courts limit the scope of a nonsolicitation agreement to those customers or clients of a business with whom the employee had contacts. Thus, in *Polly v. Ray D. Hilderman & Co.* (1987), the Nebraska Supreme Court announced as a general rule that "a covenant not to compete in an employment contract may be valid only if it restricts the former employee from . . . soliciting the former employer's clients or accounts with whom the former employee actually did business and has personal contact." North Carolina has adopted a "look-back" rule when a noncompetition agreement includes customers of the employer that an employee is not serving at the time of termination but has served in the past. Thus, if a noncompete agreement prevents an employee from serving customers for a period of 3 years after termination and it applies to any customer served by the employee within the 2 years prior to termination, North Carolina considers the actual time restriction to be 5 years (*Professional Liability Consultants, Inc. v. Todd*, 1996). Other states take a more relaxed approach allowing noncompetition restrictions that protect more than just the customers with whom the employee had contacts (cf. *Perry v. Moran*, 1987).

Similarly, courts are reluctant to allow noncompetition agreements that prevent an employee from working in any position for a competitor or that prohibit an employee from engaging in a business that is not directly competitive with the employer's business. Thus, in *Karpinski v. Ingrasci* (1971), the New York Court of Appeals upheld a noncompetition agreement that prevented an oral surgeon from engaging in the practice of oral surgery within a five-county area of New York, but it refused to enforce that part of the noncompete that would have prevented the oral surgeon from practicing dentistry. The employer did not practice dentistry and thus the former employee would not be directly competing with him. Although Virginia has allowed covenants restricting employees from engaging in the "same" or "similar" business," the Virginia Supreme Court recently invalidated a noncompetition agreement that defined a "similar" business too broadly. In *Motion Control Systems, Inc. v. East* (2001), Motion Control designed and manufactured brushless motors. Gregory East was part of the management team of Motion Control Systems with access to customer lists and new product developments. He agreed not to work for any similar business, which was defined as "any business that designs, manufactures, sells or distributes motors, motor drives, or motor controls." Because the noncompete agreement would prohibit East from working in a business that sold any type of motor, not just the specialized brushless motors sold by Motion Control, the Virginia Supreme Court refused to enforce it because it was overbroad in its scope.

Some courts partially enforce overbroad agreements not to compete to the extent that they are reasonable under one of two approaches. The traditional "blue pencil" doctrine allows the courts to modify an agreement not to compete and render it enforceable if a change is grammatically possible (cf. *Hartman v. W. H. Odell*, 1994). Under this doctrine, a court can delete language in an unreasonable agreement not to compete, thereby "penciling out" terms, and enforce the remaining part of the agreement that is reasonable (cf. *Valley Medical Specialists v. Farber*, 1999). For example, a court confronted with an agreement containing a nonsolicitation clause that it considered reasonable and a general noncompete clause that it determined to be excessive could refuse to enforce the general noncompete but still enforce the nonsolicitation agreement. Many courts also will reform an agreement not to compete, even if the modification is not grammatically possible, and enforce the agreement as reformed (cf. *BDO Seidman v. Hirshberg*, 1999). State statutes in Florida (*Fla. Stat. Ch.*, 2002b), Michigan (*Mich. Comp. Laws*, 2002), and Texas (*Tex. Bus. & Com. Code Ann.*, 2002b) specifically empower courts to reform overbroad agreements not to compete. However, some states refuse to permit reformation of any kind by statute or based on common law contract principles (cf. *Morgan Stanley DW, Inc. v. Frisby*, 2001). Moreover, even in those jurisdictions that allow reformation, a court may refuse to reform an overbroad noncompetition agreement if it finds that the employer's actions were in bad faith or otherwise egregious (cf. *Smith, Batchelder & Rugg v. Foster*, 1979).

Consideration

As with any contract, an agreement not to compete must be supported by consideration. If the agreement is executed at the beginning of the at-will relationship, or contemporaneous with it, there is sufficient consideration for the agreement. However, as is often the case, if an employee is presented with an agreement not to compete after he has worked for an employer for a period of time, there is an issue of the consideration for the employee's promise. Some jurisdictions take the position that some "new" consideration is necessary to support the employee's promise not to compete. North Carolina (*Kadis v. Britt*, 1944), South Carolina (*Poole v. Incentives Unlimited, Inc.*, 2001), Oregon (*Or. Rev. Stat.*, 2002), and Pennsylvania (*George W. Kistler, Inc. v. O'Brien*, 1975) take the position that continued employment of an at-will employee is not sufficient consideration for an agreement not to compete. There must be some change in the employee's compensation, duties or responsibilities, or some other additional consideration for the noncompete promise to be binding. This position has been rejected by a majority of courts who hold that the continued employment or the employer's implied agreement not to terminate the employee is sufficient consideration for the noncompete agreement (Yates, 1986). Illinois and some states have adopted the position that *substantial* continued employment is sufficient consideration (cf. *Woodfield Group, Inc. v. DeLisle*, 1998). This rule requires a case-by-case determination as to whether continued employment is long enough to justify the restrictive covenant. Although there is no numerical formula for this determination, Illinois courts have held that continued employment for more than 2 years was sufficient consideration for an agreement not to compete (cf. *Agrimerica, Inc. v. Mathes*, 1990) but continued employment for only seven months was not substantial enough (cf. *Mid-Town Petroleum, Inc. v. Gowen*, 1993).

In summary, agreements not to compete in the employment context are subject to strict scrutiny because of the public policy interests involved. In some states, such agreements are rarely if ever permitted or are allowed under limited circumstances. In most states, variations of the common law reasonableness standard are used to judge the validity of such agreements. The courts will invalidate noncompete agreements if they fail to serve legitimate interests of the employer, impose restrictions that are not reasonably necessary to serve those interests, or otherwise fail to comply with legal requirements. Thus, the law of employee noncompetes varies from state to state on a number of issues that may be relevant to whether an employee can be lawfully discharged for refusing to sign a noncompete agreement. Cases that have addressed that issue are discussed in the next two sections.

COURT DECISIONS ALLOWING DISCHARGE FOR REFUSING TO SIGN AGREEMENTS NOT TO COMPETE

Madden v. Omega Optical

One of the first appellate court decisions to address the issue of whether discharging an employee for refusing to sign an agreement not to compete is a wrongful discharge in violation of public policy was the Vermont Supreme Court opinion in *Madden v. Omega Optical, Inc*. (1996). In *Omega Optical*, the court held that an at-will employee could be lawfully discharged for refusing to sign an agreement not to compete even if the agreement was unenforceable. In that case, Omega Optical adopted a new personnel policy requiring employees to sign a Confidentiality, Disclosure, and Noncompetition Agreement. Although only new employees were originally required to sign the agreement, the company changed the policy and covered all employees when some existing employees left the company to start a competing enterprise. The agreement not to compete provision precluded employees from engaging in the thin-film optical coating business anywhere in the United States for 6 months after termination. Presented with this agreement as a condition of continued employment, five employees refused to sign it and were discharged.

The employees sued Omega Optical claiming a breach of implied contract and wrongful discharge in violation of public policy. The implied contract theory was based on a company handbook providing for termination after "two unsatisfactory reviews." The handbook contained a typical disclaimer, however, that nothing in it changed the at-will status of its employees. After summary judgment was granted for the company dismissing the employees' claims, they appealed to the state's high court.

Vermont had recognized the public policy exception to employment at will in *Payne v. Rosendahl* (1986). In *Payne*, the court found a wrongful discharge in violation of public policy where employees were fired solely because of their age. This public policy violation was recognized even though no Vermont statute prohibited age discrimination and the employer was not covered under the federal age discrimination law. The court concluded that age discrimination was a “practice so contrary to our society’s concern for providing equity and justice that there is a clear and compelling public policy against it.” Thus, the court adopted a broad public policy exception, one that was not confined to discharges contrary to specific statutory or constitutional provisions.

However, the *Omega Optical* court declined to extend the reach of the broad public policy exception fashioned in *Payne* to the discharge of employees for refusing to sign an agreement not to compete. The court’s conclusion that such a discharge is not contrary to public policy was based on two rationales. First, assuming the agreement was unreasonably broad as the employees contended, then there was no risk in them signing the agreement. The court was apparently not concerned with the fact that employers would be able to compel employees to sign agreements that are unenforceable as a matter of public policy. Also, there was no discussion of the moral dilemma the court was creating for employees, that is suggesting that they should sign agreements and make promises with no intention of living up to those commitments. Second, if the employees’ primary concern was in protecting their future employment opportunities from legitimate restrictions imposed by an enforceable noncompete agreement, then they were discharged properly as the employer was simply protecting its legitimate business interests. For support, the court cited *Wagenseller v. Scottsdale Memorial Hospital* (1985) and *Pierce v. Ortho Pharmaceutical Corp.* (1980) for the proposition that no wrongful discharge claim exists for terminations to protect “private or proprietary interests” of employers.

By concluding that termination for refusing to sign a noncompete agreement can never constitute a wrongful discharge in violation of public policy, the court avoided the difficult question of whether Omega Optical’s noncompete agreement was reasonable. Also, since the approach it adopted does not require an ad hoc determination of reasonableness in individual cases, courts applying the *Omega Optical* holding in the future will not have to make such judgments in wrongful discharge cases. Thus, this approach favoring employers has the benefit of simplicity and predictability. It also has the benefit of minimizing judicial interference into employment relationships by delaying decisions on the legitimacy of noncompete agreements until actions are brought to enforce them. Whether the court’s underlying assumption about the risks to employees is correct, however, and whether the approach is fair to employees, is open to question.

Tagte v. Chambers and Owen, Inc.

The *Omega Optical* opinion was cited by the Wisconsin Supreme Court when it ruled in *Tagte v. Chambers and Owen, Inc.* (1998) that the claim for wrongful discharge in violation of public policy does not encompass a discharge for refusing to sign a noncompete agreement. In that case, Wayne Tagte, a 12-year, at-will employee of Chambers & Owen, was presented with a Management Agreement that contained both nondisclosure and noncompetition provisions. Tagte objected to the terms of the agreement and was terminated for refusing to sign it. He brought suit for wrongful discharge. The wrongful discharge suit was dismissed prior to trial, the circuit court concluding that the agreement did not violate the Wisconsin statute on restrictive covenants. Tagte appealed the dismissal.

Wisconsin had adopted a "narrowly circumscribed" public policy exception in *Brockmeyer v. Dun & Bradstreet* (1983). In *Brockmeyer*, it recognized a wrongful discharge claim that had to be based on "paramount requirements of public interest" evidenced by a constitutional or statutory provision. However, subsequent Wisconsin opinions on the reach of the public policy exception created in *Brockmeyer* were conflicting and contradictory. Although characterized as a narrow exception, the court in *Wandry v. Bull's Eye Credit Union* (1986) adopted the position that the exception included discharges contrary to "the spirit as well as the letter of the statutory prohibition." In *Bushko v. Miller Brewing Company* (1986), the court limited the exception to situations in which an employee was discharged for refusing a "command, instruction or request" to violate an existing law, but it later expanded the exception to include cases where an employee was fired for complying with an affirmative obligation under the law in *Hausman v. St. Croix Care Center* (1997). Overall, Wisconsin's public policy exception is a narrow one, although it is more flexible than the exception in some jurisdictions.

In analyzing the wrongful discharge claim based on a violation of the Wisconsin restrictive covenant statute, the court considered whether Tagte had identified a "fundamental and well-defined public policy" to trigger the "narrow" public policy exception to employment at will. Wisconsin has a statutory provision on restrictive covenants in employment contracts that adopts the common law rules relating to such agreements but rejects the so-called "blue pencil doctrine." It provides

> 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. Any covenant . . . 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 (*Wis. Stat.*, 2002).

The court found that the Wisconsin statute was broad in its reach, covering not only the noncompetition agreement but also the nondisclosure agreement, and that it evidenced a strong public policy against the enforcement of unreasonable trade restraints. However, it found no public policy against forcing employees to sign such restraints. This distinction between enforcing the agreement and compelling employees to sign such agreements was at the heart of the court's decision. The court reasoned that whether a particular restrictive covenant is unreasonable is a fact-intensive determination requiring an examination of the terms of the agreement and the business context in which that agreement was entered into. If wrongful discharge claims were permissible for refusing to sign noncompete agreements, the courts would be forced to make complex determinations of reasonableness based on hypothetical facts. Recognizing wrongful discharge claims would also encourage employees to "indiscriminately decline to sign nondisclosure/noncompete agreements" and then file suit if they were fired for doing so. The court, quoting the rhetorical hyperbole of the court of appeals, reasoned that "all restrictive covenant cases would become wrongful discharge cases." Parroting the *Omega Optical* opinion, the court also believed that an employee "gambles little" by signing an unenforceable agreement, particularly under the Wisconsin statute that voids the entire covenant if any part of it is unreasonable. Rather than adopt a "dubious and unpredictable" approach to the issue, the court followed the *Omega Optical* rule that no wrongful discharge claim exists for terminating an employee who refuses to sign an unenforceable restrictive covenant.

The majority opinion in *Chambers & Owen* prompted a spirited dissent by Chief Justice Abrahamson. She argued that the strong public policy against enforcement of unreasonable restrictive covenants as reflected in the Wisconsin statute is undermined when an employee is forced to sign an unenforceable agreement. "[E]nforcement of a nondisclosure agreement starts when an employee is asked to sign the agreement," not when the employer attempts to enforce it. Noting that the legislature intended to prevent employers from abusing their superior bargaining position by forcing employees into overbroad restrictive covenants, she found that the majority's approach would actually encourage employers to use that bargaining strength to maximum advantage, forcing employees to sign broad restrictive covenants and holding the threat of enforcement over them if they contemplated leaving the employer's business. This creates a lose–lose situation for employees:

> If the employee refuses to sign the agreement, the employee risks termination without any right to sue for wrongful discharge. If the employee signs the agreement, the employee risks a lawsuit and litigation expenses when he or she chooses to violate the agreement. Alternatively, the employee who signs the agreement may feel compelled to respect his or her contractual obligations (regardless of the legality of the agreement), thereby forgoing other employment opportunities in order to avoid litigation. Moreover, prospective employers may refuse to hire an employee who has signed a nondisclosure agreement, regardless of their assessment of the legality of the agreement, for fear of buying themselves a lawsuit.

Given the public policy concerns underlying the Wisconsin statute on restrictive covenants, she believed that some of the risks of a discharge for refusing to sign an agreement not to compete should be on the employer's shoulders. Thus, she would have recognized a claim for wrongful discharge if the noncompete agreement the employee refused to sign was void.

Dymock v. Norwest Safety Protective Equipment

In *Dymock v. Norwest Safety Protective Equipment* (2002), the Oregon Supreme Court concluded that employees discharged for refusing to sign an unenforceable noncompete agreement cannot sue for wrongful discharge under the public policy exception, reversing a court of appeals decision favoring a discharged employee. Oregon has a unique statutory provision that codifies the rule adopted in some jurisdictions that new consideration is necessary for a noncompete agreement signed by an existing employee to be enforceable. The statute provides as follows:

> A noncompetition agreement entered into between an employer and an employee is void and shall not be enforced by any court in this state unless the agreement is entered into upon the: (a) Initial employment of the employee with the employer; or (b) Subsequent bona fide advancement of the employee with the employer (*Or. Rev. Stat.*, 2002).

Frederick Dymock worked for Norwest Safety for 17 years. He was ordered to sign a nonsolicitation agreement without any bona fide advancement in his employment. The nonsolicitation agreement provided in part that he could not solicit any customer of Norwest Safety (or any target of its marketing) for a period of 5 years after leaving the company. When he was terminated for refusing to sign it, he brought suit for wrongful discharge. The trial court dismissed his suit on the ground that the nonsolicitation agreement was not a noncompetition agreement. On appeal, the court of appeals rejected this conclusion, finding that a noncompetition agreement need not completely bar an employee from engaging in a business similar to his prior employer's business (*Dymock v.*

Norwest Safety Protective Equipment, 2001). The court adopted a functional interpretation of the word "compete" in the broad statutory definition of noncompetition agreement. Thus, it logically considered an agreement not to solicit customers as an agreement not to compete.

On the wrongful discharge issue, the court of appeals rejected the employer's argument that the employee had an adequate statutory remedy—nonenforcement of the noncompete agreement—and therefore a wrongful discharge remedy was unwarranted. Like other states, Oregon does not recognize a wrongful discharge claim if the statutory scheme providing the basis of the public policy violation contains an adequate remedy. The court noted that the Oregon statute on noncompete agreements provides a remedy only for those who sign agreements not to compete. It does not provide a remedy for those employees who refuse to sign a noncompetition agreement—there is no remedy for employees who resist the "surprise and oppressive tactics" that the statute was designed to prevent. The court also reasoned that Dymock was discharged for asserting an "important employment-related right." Unlike private rights and interests, this right "not to be subjected to noncompetition agreements that are unsupported by consideration" was based on statute. Thus, a claim for wrongful discharge for refusing to sign an unlawful noncompete agreement was considered analogous to claims by employees discharged for filing workers' compensation claims or asserting other employment-related rights.

The Oregon Supreme Court agreed that the agreement was a noncompetition agreement, but it rejected the lower court's analysis of the wrongful discharge issue. The court recognized that under the public policy exception it created in *Delaney v. Taco Time Int'l* (1984), an employee could bring a wrongful discharge claim if he or she was terminated for pursuing an employment-related right, such as a filing a workers' compensation claim. However, the court concluded that Dymock was not so discharged since the Oregon statute does not give employees the right to not sign an illegal noncompetition agreement. The court reasoned that the statute renders agreements in violation of the statute to be unenforceable, but it does not expressly create a right to refuse to sign such agreements. The court further believed it improper to alter the statute by reading language into it creating such an employment right, leaving the matter of statutory amendment to the legislature.

COURT DECISIONS ALLOWING WRONGFUL DISCHARGE CLAIMS FOR FIRING EMPLOYEES WHO REFUSE TO SIGN AGREEMENTS NOT TO COMPETE

D'Sa v. Playhut, Inc.

It is not surprising that two California appellate courts have addressed the issue of whether an employee dismissed for refusing to sign a noncompete agreement can maintain a wrongful discharge claim. California is the birthplace of the public policy exception to the employment-at-will doctrine and is considered to be one of the jurisdictions that takes a broad approach to that exception. Moreover, California has one of the most restrictive state statutory provisions on employee noncompete agreements. California law (Section 16600) provides: "Every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void (*Cal. Bus. & Prof. Code*, 2002)." The California courts have vigorously enforced this statute, finding a "strong public policy" in favor of the rights of employees to be free of restrictive covenants. Therefore, one would expect California courts to be receptive to the argument that discharging an employee for refusing to sign a noncompete agreement is a wrongful discharge in violation of the strong public policy expressed in Section 16600.

In *D'Sa v. Playhut, Inc.* (2000), the court held that California recognized such a wrongful discharge claim. In that case, Richard D'Sa was fired for refusing to sign a "confidentiality agreement" that contained a noncompete provision along with a severability clause. In his suit for wrongful discharge in violation of public policy, summary judgment was granted for the employer on the ground that the noncompete provision was part of a broader employment contract with a severability clause. A severability clause provides that if a provision of a contract is deemed illegal by the courts, the other terms of the contract are enforceable. The appeals court disagreed, however, concluding that "an employer cannot lawfully make the signing of an employment agreement, which contains an unenforceable covenant not to compete, a condition of continued employment, even if such agreement contains . . . severability provisions which would enable the employer to enforce other provisions of the employment agreement."

The *D'Sa* court addressed several of the arguments advanced by the courts in Wisconsin, Vermont and Oregon to deny employees a right to pursue a wrongful discharge claim when they were discharged for refusing to sign an agreement not to compete. The court specifically rejected the argument that the restrictive covenant statute does not prevent an employer from firing an employee who refuses to sign an agreement, only from enforcing the agreement not to compete. "California law would protect plaintiff if defendants sought to overreach by trying to enforce the covenant not to compete, and California law will also protect him from a termination of his employment brought on by his refusal to sign an agreement containing the illegal covenant." In rejecting the contrary position, the California court relied on the analogous case of *Baker Pacific Corp. v. Suttles* (1990), a case in which asbestos removal workers were required to sign an invalid release form as a condition of employment. In *Baker*, the employer had argued that since the release was invalid and of no legal force and effect, that requiring workers to sign the agreement also could not be contrary to law, a position the *Baker* court found "circular and unintelligible." Playhut made a similar argument based on the severability clause, asserting that the agreement could not be interpreted against the employee contrary to Section 16600 because of this saving clause. The court found the argument unpersuasive:

> It is clear that the severability clause exists for the benefit of Playhut, not Playhut's employees . . . Moreover . . . it is not likely that Playhut's employees are sufficiently versed in California's law of contracts such that they would know (1) that the covenant not to compete is invalid and therefore not enforceable by Playhut and (2) that they could sign the agreement without fear they would be bound by the covenant not to compete.

Thus, the court implicitly rejected the argument adopted by the courts in *Omega Optical* and *Chambers & Owen* that signing an unenforceable noncompete agreement is without costs or risks to the employee. Not only are there potential costs to the employee, but the *Playhut* court opines that many employees will be unaware of their rights under the law and will forego those rights by living up to their agreements not to compete. Paraphrasing the language in *Baker,* the court concluded

> An employment relationship, where hiring is conditioned on statutorily proscribed terms, is not acceptable to us. Moreover, it has the potential for bringing serious mischief to the workplace, We cannot expect workers to be cognizant of their section 16600 rights. We reject the concept that a worker, compelled by necessity to secure employment, can be thus coerced into signing

> sweeping agreements to not compete with their employers upon leaving the employment in the uninformed hope the agreement will not be enforced by the courts. We foresee situations where the uninformed . . . employee will forego legitimate employment rather than assume the risk of expensive, time-consuming litigation by the former employer.

Walia v. Aetna, Inc.

Perhaps the most publicized wrongful discharge case involving an employee who refused to sign an agreement not to compete is the California appeals court decision in *Walia v. Aetna, Inc.* (2001), a case that is presently under review by the California Supreme Court. Anita Walia was an Account Manager in the San Francisco office of Aetna. After Aetna merged with U.S. Healthcare to form Aetna U.S. Healthcare, the president of the company required a number of Aetna employees to sign a Noncompete and Confidentiality Agreement, a policy that had been followed in the old U.S. Healthcare. Ms. Walia was presented with the agreement that would have precluded her from working for any competitor in the State of California after leaving the company. She was an attorney by education, and so she researched the validity of the agreement under California law and concluded that the agreement was "pretty much unenforceable." She brought her concerns about the noncompetition agreement to four senior managers, all of whom asserted that the noncompete agreement was enforceable under Pennsylvania law. She informed her superiors that she would sign the agreement if the covenant not to compete was removed. She also had an attorney send a letter to the president advising him that the noncompete agreement was unenforceable and that there was potential liability for wrongful discharge if an employee was fired for refusing to sign such an agreement. Nevertheless, Aetna later fired Walia and placed a letter in her personnel file stating that she had been fired for "failure to meet the requirements of your position." She sued for wrongful discharge, and a jury awarded her $1.2 million, including $1.08 million in punitive damages.

On appeal, Aetna attempted to argue that the agreement fell within one of the judicially crafted exceptions to Section 16600, either as a "narrow restraint" on a "limited" part of a business (cf. *Boughton v. Socony Mobil Oil Co., Inc.*, 1964). or as a necessary protection for trade secrets. Each of these arguments was rejected in turn. The "limited restraint" exception was readily disposed since Aetna's noncompete agreement was quite broad. Also, a recent federal district court opinion, *Latona v. Aetna U.S. Healthcare, Inc.* (1999), had found the exact same noncompete agreement to be in violation of the California statute and not a "limited restraint." The court similarly dismissed the trade secret argument, noting that the Aetna agreement contained a separate trade secret provision and finding the restraint on working for a competitor to be broader than the typical nondisclosure agreement.

Aetna also claimed that the public policy was not clearly articulated nor fundamental, requirements under California's formulation of the public policy exception. The court relied on the fact that the public policy against employee noncompete agreements had been established for over 100 years, and numerous court decisions had consistently enforced the law. This history of court cases enforcing Section 16600 put Aetna on notice that the public policy against noncompete agreements was clearly articulated and fundamental.

MANAGERIAL IMPLICATIONS AND ANALYSIS

Walia indicates that there may be a significant liability risk in terminating an employee for refusing to sign an agreement not to compete. In assessing that risk in a state that has not ruled on the issue, managers and their counsel need to make an educated judgment as to how the issue will likely be resolved by the courts in their particular jurisdiction. Clearly, whether a state court recognizes a claim for wrongful discharge for terminations based on an employee's refusal to sign a noncompete agreement will primarily depend upon two factors: (1) the nature of the public policy exception, whether narrow or broad, in that particular jurisdiction, and (2) the strength of the state's public policy against employee noncompete agreements.

States with a broad conception of the public policy exception will most likely recognize such a wrongful discharge claim, particularly if the state has a strong public policy against noncompete agreements. Thus, the decisions in *D'Sa* and *Walia* were quite predictable. However, Vermont also had adopted a broad public policy exception, but it refused to recognize such a wrongful discharge claim. In part, the *Omega Optical* holding may reflect the lack of any statute or strong public policy against employee noncompetes in that state. Also, states with statutory prohibitions against or limitations on agreements not to compete will similarly be likely to recognize such a wrongful discharge claim. This may be the case even if the state takes a narrow view of the public policy exception since there would be a statutory basis for the public policy violation.

States with a narrow conception of the public policy exception will be less likely to recognize such a wrongful discharge claim. *Dymock* and *Chambers and Owen* represent the likely resolution of the issue when the court takes a narrow view of the public policy exception. Also, a state without a strong public policy against employee noncompete agreements will be less likely to recognize a wrongful discharge claim in this context. The outcome may depend upon whether the court can be persuaded to recognize a general statutory prohibition against trade restraints that exists in all states, coupled with the long-standing common law suspicion of employee restrictive covenants, as a sufficient basis for a public policy violation. Future court decisions on this issue also will depend upon the soundness and persuasiveness of the arguments and counterarguments that were advanced by the court decisions favoring and rejecting a wrongful discharge claim.

In allowing employers to discharge employees for refusing to sign a noncompete agreement, the *Omega Optical*, *Chambers & Owen*, and *Dymock* courts posited several arguments. First, a common theme in the Vermont and Wisconsin opinions was the argument that an employee has no risk and incurs no costs by signing an unenforceable agreement. The logic is that if the agreement is overbroad, it will not be enforceable against the employee. The weaknesses in this argument were clearly demonstrated by the dissenting opinion of Chief Justice Abrahamson in *Chambers & Owen* and the California court in *D'Sa*. There may be costs in establishing the invalidity of the agreement, and the threat of litigation may deter prospective employers from hiring the employee (cf. *Kallok v. Medtronic, Inc*., 1998). Also, employees may not understand the law of employee noncompete agreements, and as a result, they may voluntarily live up to their agreements assuming they are enforceable. Finally, a serious issue about "costs" that was not addressed by any of the courts is the moral dilemma created by their opinions. Should the law force employees into the position of making promises that they don't intend to live up to or consider binding?

Second, the contention is made that there is no public policy violation in having employees sign unenforceable noncompete agreements, only in enforcing them. This distinction should be a meaningless one under the public policy exception. The underlying theoretical basis for the exception is that an employer should not be able to undermine legitimate and important public policies by terminating an employee. Thus, an employee discharged for filing a workers's compensation claim has a wrongful discharge claim. The notion is that the system of workers's compensation would be undermined if employers could fire employees for filing claims for workplace injuries. It should not make any difference whether the employee is fired for filing the claim or refusing to sign an agreement not to file a claim. Similarly, the argument can be made that forcing employees to sign unreasonable agreements not to compete undermines public policies prohibiting the enforcement of such agreements. This is particularly the case when one considers that the primary societal concerns with employee noncompete agreements are preserving employee mobility, minimizing employer overreaching, and maintaining free competition in the marketplace.

Third, the strongest argument against recognition of a wrongful discharge claim, advanced by the court in *Omega Optical*, relates to the difficulty of determining the enforceability of an agreement not to compete in advance of its enforcement. Clearly, the question of reasonableness under the common law test depends upon the unique facts and circumstances surrounding the employer's business, the employee's job, and the nature of the market for the employer's goods and services. Moreover, these variables may change over time. An entry-level employee may advance to a position where he or she has greater access to proprietary business information. An employee may over time develop extensive contacts and clients in the marketplace. The company may have a local presence at an early stage of its development, but later gain a regional or national presence. Thus, it is difficult to judge in advance whether an agreement not to compete is lawful, which would be required if a wrongful discharge claim for refusing to sign a noncompete agreement is recognized.

A related argument also can be made that courts should exercise restraint in interfering with business-related decisions on employment issues, and defer the resolution of such disputes until it is necessary to do so. This sort of "hands off" approach to business decision making is one of the underlying bases for the employment-at-will doctrine and the limited nature of the public policy exception. Even though this argument has some appeal, the counter-argument is that some agreements not to compete will be patently unenforceable under any set of facts. Thus, without a bona fide advancement, the noncompete agreement in *Dymock* was unenforceable regardless of the facts. In *D'Sa* and *Walia*, it also was clear that the agreements were unenforceable as a matter of law. Whether the court should delay the ruling on such patently unenforceable agreements involves a consideration of the costs and risks to the employee, which as discussed, may be substantial.

Finally, the argument that recognizing a wrongful discharge claim in this setting will open a Pandora's box of litigation seems overblown. Not every noncompete agreement case will become a wrongful discharge case for several reasons. First, many agreements not to compete are entered into at the start of the employment relationship and thus presumably would not trigger any wrongful discharge claim. Second, most employees would continue to sign agreements not to compete without questioning or challenging the validity of the agreements. Few employees want to jeopardize their relationships with others and the work environment by refusing to go along with company directives. Many would assume that the agreements are lawful or consider them to be of little or no consequence. Third, an employee who wanted to refuse to sign an agreement would have a difficult legal decision, particularly if the invalidity of the agreement was not clear. An employee refusing to sign a noncompete agreement could be terminated and then have to incur the expenses associated with bringing a wrongful discharge claim. In that suit, the burden would rest on the employee to prove the unreasonableness of the agreement. Rather than refuse to sign, an employee might opt to sign an agreement where the enforceability is disputable or unclear. The employee could then wait and challenge the agreement if the company sought to enforce it after his or her employment ended. This would shift much of the cost and burden of litigating to the employer who would have to convince the court that the agreement was reasonable, overcoming the strict scrutiny courts employ in these cases. From a tactical position, the dynamics of the lawsuit change if an employee challenges a noncompete agreement at the time of its enforcement. Thus, in many situations where an employee has grounds to refuse to sign a noncompete agreement, the employee will choose not to do so because of the costs and uncertainty of a wrongful discharge claim.

CONCLUSION

In today's highly competitive global environment, businesses are increasingly becoming aware that the key to their success lies within their workforce. Their employees are in fact their most important asset. Some organizations have opted to utilize modern human resource management practices to create an environment where employees become committed to the long-run success of the organization (cf. Lawler, 1992; Pfeffer, 1998). On the other hand, some organizations choose to have employees (especially key employees) sign noncompete agreements in an effort to protect their business interests in case an employee chooses to leave the organization.

As demonstrated in this article, noncompete law is complex and highly variable from state to state. What may be an enforceable agreement in one instance may not be enforceable in another. This is further compounded when the public policy exception to the employment-at-will doctrine is considered in tandem with requiring employees to sign noncompete agreements. As we have discussed, the public policy exception varies widely from state to state, with some states interpreting it broadly, others narrowly, and some not accepting it at all. As such, if an organization determines that it wants to use noncompete agreements as a tool to encourage employee retention and to discourage employees from going to work for a competitor, it needs to realize that there are many issues to consider: Is the agreement legal? Is the scope of the agreement unreasonable? Are we at risk of losing a wrongful discharge case should we terminate an employee for not signing an agreement? These questions become increasingly important (and complex) if the organization is operating in multiple states. Thus, an employer should approach the use of noncompete agreements, and the termination of employees who refuse to sign such agreements, with due care.

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