THE ENFORCEABILITY OF NO-HIRE PROVISIONS IN MERGERS, ACQUISITIONS AND OTHER ENTREPRENEURIAL VENTURES

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Abstract

Human capital has become the principal competitive advantage for many businesses in today's increasingly specialized marketplace. In order to protect human capital, no-hire agreements have become boilerplate provisions in many types of contracts. Despite their prevalence, these agreements have not been uniformly and predictably enforceable, due to conflicting methods of interpretation from state to state. Depending on the state, one of three approaches will be employed to determine enforceability: (1) the antitrust approach, (2) the contracts in restraint of trade approach, or (3) the covenants not to compete approach. Over the past several decades, the contracts in restraint of trade and covenants not to compete approach have been the predominant methods of interpretation. Nevertheless, several recent cases employed the antitrust approach, suggesting that it may still be a viable option. This note examines the enforceability of no-hires under each of these approaches. Specifically, this note evaluates the enforceability of no-hires executed in merger agreements as well as those executed ancillary to employee staffing contracts. Additionally, this note discusses the increased potential for forum shopping as a technique to successfully challenge enforceability.

I. INTRODUCTION

"Increasingly, the true value of corporate assets being bought and sold lies in 'human capital,' that is, the knowledge, technical expertise, and collective experience of a company's employees."[1] Because human capital

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[1] Brian R. Henry & Joseph M. Miller, *"Sorry, We Can't Hire You... We Promised Not To": The Antitrust Implications of Entering Into No-Hire Agreements*, 11 ANTITRUST FALL 1996, at 39.

often provides a firm's competitive advantage, it is frequently the prime target of a potential acquirer or competing business.[2] This note examines the enforceability of a contractual provision designed to protect human capital, commonly referred to as a "no-hire" or "no-switching" provision.[3]

No-hire provisions ("no-hires") are common in a variety of business agreements. However, this Note will focus on two scenarios that relate closely to entrepreneurship. The first scenario involves a corporation that is considering a merger or acquisition. If a corporation is looking to be acquired, the corporation has a strong interest in introducing the potential suitor to key employees to highlight the employees' unique skills.[4] This information, and the employees' talents, are valuable and may increase the attractiveness of the deal.[5] Moreover, acquirers realize that the physical assets they purchase are less valuable without experienced personnel to manage them.[6] However, the corporation also must be careful not to reveal too much, in order to protect their human capital should deal negotiations crumble.[7] Because of this dilemma, it is standard for companies to require the potential acquirer to agree to a no-hire agreement which prevents the other party from "poaching" key employees.[8] No-hires thus facilitate information sharing and increase the probability that a mutually appealing deal will be reached.

Similarly, the acquirer also has an interest in utilizing a no-hire agreement, although for a somewhat different purpose. Assuming the acquisition is successful, the acquiring corporation possesses an interest in retaining the human capital that was purchased.[9] Specifically, the acquiring company faces the risk that the seller could rehire the employees, stripping much of the value from the acquisition.[10] Therefore, acquirers also frequently insist on the execution of no-hires.

The second scenario involving no-hires arises when one company executes a contract to provide temporary employees or employee services

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[2] Rob Garver, *Merge Right: Numbers Don't Drive Deals. People Do.*, CFO MAG., Feb. 15, 2006 at 12.

[3] In many instances, there are additional contractual provisions executed to protect business assets, such as confidentiality agreements and other employment agreements. However, the enforceability of these agreements is outside the scope of this analysis.

[4] James Wright, *Pitfalls of Poaching Employees After a Deal Craters; Luring talent from a suitor, or losing employees after deal talks crumble presents risks for both companies*, MERGERS & ACQUISITIONS, Apr. 1, 2007, at 88.

[5] *Id.*

[6] Henry & Miller, *supra* note 1, at 39.

[7] Wright, *supra* note 4, at 88.

[8] *See* Henry & Miller, *supra* note 1, at 39.

[9] *Id.*

[10] *Id.*

to another company.[11] In this situation, the supplier will often demand a no-hire provision to prevent the purchaser from simply hiring the employees and cutting out the "middle-man" services of the supplier.[12]

Unfortunately for sellers, purchasers, and suppliers, the enforceability of these agreements varies from state to state. This inconsistency is due to the fact that courts across the nation have not agreed upon the proper method to analyze no-hire agreements.[13] Two conflicting legal principles frame this discussion and highlight the problem of enforceability.[14] The first involves freedom of association, and the right of an employee to accept the job of her choice. Many courts are highly protective of an employee's right to work. The second involves freedom of contract and the right of an employer to protect its assets and remain free from unfair competition.[15] Many courts are sympathetic to this right as well, but often require narrowly tailored provisions and strike down overbroad prohibitions.

II. THE COMPETING APPROACHES

Historically, courts would apply legal principles of antitrust law to analyze no-hire agreements.[16] Under this approach the critical issue is whether the agreement constitutes an unreasonable restraint of trade.[17] This analysis generally focuses on the big picture–how the enforcement of such provisions could potentially affect trade as a whole, as opposed to the effect on individuals.[18] However, over the past several decades state courts have largely moved away from applying antitrust principles, and adopted one of the two competing approaches: (1) state law governing contracts in restraint of trade, or (2) state law governing restrictive covenants. Nevertheless, despite the prevalence of these modern approaches, two cases decided in 2007 suggest that the antitrust approach may be reviving.[19] It is yet to be

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[11] David K. Haase & Darren M. Mungerson, *Agreements Between Employers Not To Hire Each Other's Employees: When Are They Enforceable?,* 21 LAB. LAW. 277, 277 (2006).
[12] *Id.*
[13] *Id.*
[14] Wright, *supra* note 4, at 89.
[15] *Id.*
[16] Haase & Mungerson, *supra* note 11, at 277.
[17] *Id.*
[18] *Id.*
[19] *See,* Deich-Keibler v. Bank One, 243 Fed.Appx. 164, 165 (7th Cir. 2007); Eichorn v. AT&T Corp., 248 F.3d 131 (3d Cir. 2007) (In *Eichorn,* the Third Circuit Court of Appeals had to decide whether defendant's agreement to restrict the hiring of certain employees, upon the former employer's sale of the company, was a violation of § 1 of the Sherman Act. Most importantly, the Court determined that the plaintiffs were injured, and had

seen if those decisions are an anomaly, or if they represent the genesis of a new trend. Either way, understanding the antitrust approach is critical, because it established the foundation for the reasonableness analysis employed by the contracts in restraint of trade approach.

Regardless of which approach is used, the reasonableness of the no-hire provision is central to determining its enforceability. However, the emphasis and scope of the reasonableness analysis varies depending on the approach. Under the restraint of trade approach, the reasonableness analysis is focused on the potential harm to society if such provisions were routinely enforced, rather than the harm to specific individuals.[20] Because of the broad focus, this approach is more closely aligned with the antitrust approach.[21] Additionally, this approach is generally beneficial for parties seeking enforcement, because it is easier to demonstrate that enforcement of the provision is reasonable, necessary, and not potentially harmful to society. This contrasts with the more stringent individually-focused reasonableness analysis employed under the restrictive covenant approach.[22]

The second predominant approach analogizes no-hires to restrictive covenants between employers and employees and applies the applicable state law governing such agreements.[23] The enforceability of restrictive covenants varies significantly from state to state. However, in general, an agreement that contains post-employment restrictive covenants will be enforceable if it is reasonably necessary to protect the employer and not unduly harmful to the employee.[24] This approach is generally less preferable for those seeking enforcement, for two reasons. First, different states apply different standards to determine what is "reasonably necessary." This variation can lead to inconsistent enforceability. Second, this approach emphasizes the reasonableness and necessity of the restrictions on the individual, rather than the potential impact on society.[25]

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standing to sue under the Sherman Act. However, the Court determined that there was not a violation of the Act, because (1) the agreement was reasonable in scope and (2) the primary purpose of the agreement was to ensure the successful and uninterrupted acquisition of the company, whose business required workforce continuity. Consequently, any restraint on plaintiffs' ability to seek employment was incidental to the effective sale of the company); *See also,* Roman v. Cessna Aircraft Co., 55 F.3d 542, 545 (10th Cir. 1995).

[20] Haase & Mungerson, *supra* note 11, at 277.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] Roger T. Brice & Burton L. Reiter, Prac. L. Inst., *Drafting Employment-Related Agreements*, 227 (2007). Many states will enforce the agreements if they are reasonably necessary to protect the employer's protectable interests – generally described as being confidential, competitively valuable information and customer contacts or goodwill.

[25] Haase & Mungerson, *supra* note 11, at 279.

As a corollary of the previous discussion, it is easier to demonstrate harm to an individual, as opposed to the potential harm to society if such agreements were routinely enforced.

Due to the conflicting methods of analysis, generally an agreement that is unenforceable under the contracts in restraint of trade approach will also be unenforceable under the restrictive covenant approach.[26] However, the inverse is not necessarily true.[27] Since the restraint of trade analysis is generally easier to satisfy, it may be the case that a no-hire that is enforceable under this approach may be unenforceable under the restrictive covenants approach.[28]

A. *The Antitrust Approach*

Despite the prevalence of the two principal approaches, two cases decided in 2007 in the Third and Seventh Circuit Courts of Appeals suggest that the antitrust approach may once again be a viable option to contest enforcement of no-hires.[29] The Third Circuit case involved a no-hire agreement between AT&T and one of its affiliates that it was looking to sell, Paradyne Corporation.[30] In order to market Paradyne, AT&T adopted a human resource plan that precluded AT&T from rehiring any Paradyne employee who left voluntarily for 8 months following the acquisition.[31] Shortly thereafter, Paradyne was acquired by the Texas Pacific Group.[32] Acquiring the technical skills of Paradyne's employees was central to the acquisition for Texas Pacific Group. [33]

Subsequently, AT&T was sued by several former Paradyne employees, alleging multiple harms.[34] For the sake of this analysis, the most important claim was an alleged violation of § 1 of the Sherman Act.[35] "In order to assert a cause of action under § 1, plaintiffs must prove they have suffered an antitrust injury that is causally related to the defendant's allegedly illegal anti-competitive activity."[36] An antitrust injury is an injury which naturally flows from that which makes a defendant's acts unlawful–promoting unfair competition.[37] Then, if an antitrust injury is found to

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[26] *Id.* at 280.
[27] *Id.* at 280-81.
[28] *Id.* at 280.
[29] *Eichorn*, 248 F.3d at 136; *Deich-Keibler*, 243 Fed.Appx. at 165.
[30] *Eichorn*, 248 F.3d at 136.
[31] *Id.* (For AT&T, the human resource plan effectively operated as a no-hire provision between itself and Paradyne).
[32] *Id.*
[33] *Id.* at 137.
[34] *Eichorn*, 248 F.3d at 137.
[35] *Id.*
[36] *Eichorn*, 248 F.3d at 137 (citing Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977)).
[37] *Brunswick Corp.* 429 U.S. at 489 (1977).

exist, the next step is to apply the rule of reason.[38] Upon application of the test, the Court determined that the plaintiffs had suffered an antitrust injury, and had standing to sue under the Sherman Act. However, the Court also determined that the agreement satisfied the rule of reason, and was nevertheless enforceable, because (1) the agreement was reasonable in scope and (2) the primary purpose of the agreement was to ensure workforce continuity at Texas Pacific Group, not stifle competition.[39] Consequently, any restraint on plaintiffs' ability to seek employment was incidental to the effective sale of the company.[40]

The Seventh Circuit case involved a similar fact pattern.[41] In *Deich-Keibler*, the no-hire agreement was executed between Bank One and RBC, in connection with RBC's acquisition of Bank One's mortgage loan sales division.[42] In negotiating the acquisition, RBC and Bank One executed a no-hire that restricted Bank One from rehiring any of the employees that RBC offered a job, for a period of 180 days.[43] Following the acquisition, several Bank One employees refused the offer from RBC, and sought employment with another division of Bank One.[44] When the employees learned that Bank One was contractually prohibited from hiring them, they filed suit alleging multiple claims.[45] For the purpose of this analysis, the most important claim was the assertion that the no-hire provision was an unlawful restraint of trade in violation of Indiana's antitrust act, I.C. § 24-1-2-1.[46]

First, the court noted that the Indiana Antitrust Act was modeled after the Sherman Antitrust Act, and had been interpreted consistently with the Sherman Act.[47] As previously discussed, in order to succeed in their antitrust claim plaintiffs must demonstrate the existence of an antitrust injury.[48] In the case at bar, there was no evidence suggesting that anti-competitiveness was the purpose of the no-hire agreement.[49] Therefore, the court determined that plaintiffs had not demonstrated an antitrust injury and defendants were entitled to summary judgment regarding the antitrust claim.[50]

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[38] *Eichorn*, 248 F.3d at 138 (citing United States v. Topco Assocs., Inc., 405 U.S. 596, 606 (1972)).
[39] *Eichorn*, 248 F.3d at 146.
[40] *Id.*
[41] *Deich-Keibler*, 243 Fed.Appx. at 164, 165.
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] *Deich-Keibler*, 243 Fed. Appx. at 168
[47] *Id.*
[48] *Id.*
[49] *Id.*
[50] *Id.*

Although the antitrust challenges in both *Eichorn* and *Deich-Keibler* were unsuccessful, both cases are nevertheless significant. In each case the Court carefully scrutinized the antitrust claims, suggesting that the antitrust approach could potentially be successful in challenging the enforceability of a no-hire. In both cases the courts discussed the necessity of such agreements to effectively facilitate the merger. Moving forward, it may be worthwhile for a plaintiff to challenge enforceability according to principles of antitrust law, especially if the business necessity for enforcement is not strong and the likelihood of success under another approach is weak.

Unfortunately for the party contesting enforcement, the result in both of these cases also appears to be part of a larger trend. Regardless of the decade or the approach, a party seeking enforcement of a no-hire agreement executed ancillary to a merger has a strong likelihood of success.[51] Necessity is frequently the justification for this result, because a rational buyer will be wary to invest if his targeted asset, human capital, could disappear shortly after the close of the transaction.[52] Therefore, most courts will enforce no-hires executed ancillary to the sale of a business, so long as they are reasonable, in order to provide an incentive for individuals to invest in human capital.[53]

However, this author has not discovered any recent cases employing an antitrust argument to challenge the enforceability of a no-hire involving an employee staffing/service contract. In general, no-hires in these types of situations have been found unenforceable more often than no-hires executed ancillary to the sale of a business. Therefore, it may be worth pursuing an antitrust challenge in this type of situation.

B. *The Restraint of Trade Approach*

Despite the two cases from 2007, many courts addressing no-hires in the past several decades have analyzed enforceability under restraint of trade principles.[54] Under this approach, an agreement will generally be enforceable if it is reasonable in duration and scope, and operates to serve a legitimate business purpose.[55] However, the enforceability of the

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[51] *See* Henry & Miller, *supra* note 1, at 40.

[52] *Id.; See generally* Cesnik v. Chrysler Corp., 490 F.Supp 859 (1980). Chrysler sold the assets from its Airtemp Division to the Fedders Corporation. As part of the sale, the companies executed a no-hire agreement, wherein Chrysler agreed not to hire any of its former employees from the Airtemp division. This agreement was challenged under the Sherman Act. Although the Court determined that the employees had standing to sue under § 1 of the Sherman Act, the court denied relief to plaintiffs. The result was based on the fact that the restraint was reasonably necessary for Fedders to protect the human capital that he purchased.

[53] *See*, Henry & Miller, *supra* note 1, at 40.

[54] Haase & Mungerson, *supra* note 11, at 285.

[55] *Id.*

agreement will also depend on the potential anticompetitive effect on the market, if such agreements were routinely enforceable.[56]

To assess the potential effect on the market, the first task is to determine the breadth of the relevant market.[57] Typically, the market will be defined as the market for the services of the employees affected by the agreement.[58] Additionally, it is also useful to examine the duration, geographic scope, and the alternative employment opportunities available to the affected individuals.[59] Although there are not rigid guidelines regarding these factors, reasonable restrictions and alternative employment opportunities add weight to the argument for enforceability. In contrast, the biggest threat to enforceability involves contracts restricting employees who are extremely specialized or skilled, so that they may only be employed by a small percentage of employers.[60] A challenge involving such a uniquely skilled employee may lead to an agreement being struck down under restraint of trade principles, because society may be adversely affected if a significant percentage of the available work force for a given market is restricted from employment.[61]

1. Applying Restraint of Trade Principles to Mergers & Acquisitions

Courts applying restraint of trade principles have also recognized the economic necessity of enforcing no-hire agreements executed ancillary to a merger. It would be economically inefficient and undesirable not to protect human capital bargained for in an acquisition.[62] If the human capital acquired in such a deal was left unprotected, such a rule would likely have a chilling effect on the acquisitions and investment community, and impede otherwise desirable business combinations.

However, until as recently as December of 2006, this conclusion was not uniformly recognized. In late 2006, the Alabama Supreme Court overruled a prior decision concluding that a no-hire agreement was per se void unless accompanied by an underlying employer/employee covenant not to compete.[63] The rationale behind the old Alabama rule was that it would be unfair to restrict an employee's rights without notice by contracting with another employer, when the same result could be reached

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[56] *Id.* at 278.
[57] *See*, Henry & Miller, *supra* note 1, at 41.
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] *See* Henry & Miller, *supra* note 1, at 41.
[63] *Ex parte* Howell Eng'g & Surveying, Inc., 2006 Ala. LEXIS 346, at *25 (Ala. 2006) (overruling Dyson Conveyor Maint., Inc. v. Young & Vann Supply Co., 529 So.2d 212 (Ala. 1988)).

through a direct non-competition agreement with the employee.[64] Although this decision has been overruled, at least one other court has considered the requirement of notice to the affected employee and held it to be a prerequisite to enforceability.[65] However, *Heyde* did not involve a no-hire executed ancillary to the sale of a business.[66]

2. Applying Restraint of Trade Principles to Employee Staffing Contracts

Contrary to the widespread approval of no-hires executed ancillary to a merger, there have been a handful of courts that have refused to enforce no-hires when they involve a contractual arrangement wherein one company provides services or employees to another company. The unwillingness to enforce such agreements highlights the conflict between the two underlying legal principles. It is difficult to strike a harmonious balance between the right of employees to accept jobs of their choice, and the right of employers to enter contracts and protect their assets.

The Supreme Court of South Dakota is one court that has strictly interpreted such agreements, concluding that such contractual arrangements are per se void under South Dakota's restraint of trade statute.[67] This rule emanated from a 1998 case wherein plaintiff computer company CTS, contracted to provide computer services to defendant Gateway.[68] The agreement contained a no-hire that restricted Gateway from hiring, soliciting, or recruiting any employee of CTS for the duration of the contract and one year thereafter.[69] Subsequently, a former CTS employee became employed with Gateway, and CTS brought suit to enforce the no-hire.[70]

The South Dakota Supreme Court determined that although the no-hire was similar to a non-competition agreement, the proper method to interpret the provision was under restraint of trade principles.[71] Although CTS argued that the no-hire fit within the employer/employee restrictive covenant exception to the restraint of trade statute, the South Dakota Supreme Court explicitly rejected this rationale, concluding that the

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[64] *Dyson Conveyor Maint*, 529 So.2d at 215.

[65] *See* Heyde Companies, Inc. v. Dove Healthcare, LLC, 654 N.W.2d 830, 844 (Wis. 2002). The Wisconsin Supreme Court struck down the no-hire because the employee did not receive notice of the restriction. However, the case did not involve a no-hire ancillary to a merger. *Heyde* will be discussed in more detail later in this analysis.

[66] This author has not discovered another case in any jurisdiction that has refused to enforce a no-hire executed ancillary to a merger under restraint of trade principles.

[67] Communication Tech. Sys. v. Densmore, 583 N.W.2d 125, 128-29 (S.D. 1998).

[68] *Id.* at 126.

[69] *Id.*

[70] *Id.*

[71] *Id.* at 127.

exception did not apply to an agreement between an employer and its customers.[72]

This decision is unique because it is the only case this author discovered where a no-hire would have been *easier* to enforce under state restrictive covenant laws.[73] As previously discussed, this is abnormal because a reasonableness analysis under state restrictive covenant laws is generally more rigorous. This author has not discovered support for the South Dakota approach in any other jurisdiction.

In Georgia, the Court of Appeals applied similar logic to a slightly different factual scenario, striking down a no-hire as an unreasonable restraint of trade.[74] In the *Club Properties* case, the two parties entered into a lease agreement, which called for liquidated damages if the lessee, Atlanta Offices-Perimeter, Inc., hired any of the lessor's employees.[75] Upon expiration of the lease, one of the lessor's employees went to work for the lessee.[76] Club Properties then sued Atlanta Offices to recover liquidated damages pursuant to the terms of the contract.[77]

The Georgia Court of Appeals concluded that regardless of what the parties called the provision, the liquidated damages clause operated as a restraint of trade.[78] According to Georgia law, the court then applied the "rule of reason," to determine if the agreement was enforceable as a partial and reasonable restraint of trade.[79] To satisfy the rule of reason in Georgia, the restraint must be reasonable "as to limitation of time, territory and proscribed activities."[80] The court then struck down the agreement because it did not contain any temporal limitation, and thus Atlanta Offices would never be able to hire a new employee without first determining whether she had been employed by Club Properties during the preceding six-month period.[81]

In 2007, a similar liquidated damages provision was struck down in California as an unreasonable restraint of trade.[82] In the *VL Systems* case, the parties entered into an agreement that restricted Star Trac from hiring any employee of VL Systems for one year following the termination of the contract.[83] Within that period, Star Trac breached the agreement and hired

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[72] *Id.* at 130.
[73] *See Densmore*, 583 N.W.2d at 125; Haase & Mungerson, *supra* note 11, at 295.
[74] Club Properties Inc., v. Atlanta Offices-Perimeter Inc., 348 S.E.2d 919, 922 (Ga. Ct. App. 1986).
[75] *Id.* at 920.
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.* at 922.
[80] *Club Properties*, 348 S.E.2d at 922 (citing Durham v. Stand-By Labor of Georgia Inc., 230 Ga. 558, 561 (Ga. 1973)).
[81] *Club Properties*, 348 S.E.2d at 922.
[82] VL Sys., Inc. v. Unisen, Inc., 152 Cal. App. 4th 708, 718 (Cal. Ct. App. 2007).
[83] *Id.* at 709-10.

an employee of VL Systems.[84] First, the California court distinguished the agreement from a non-competition agreement because it was between employers, not an employer and an employee.[85] The court then determined that regardless of what the provision was called, it constituted an illegal restraint of trade, in violation of California Business and Professional Code § 16600.[86] This conclusion was based on the finding that the provision was unnecessarily broad, and the need for enforcement was outweighed by the public policy interest in promoting the mobility of employees.[87]

C. *The Restrictive Covenant Approach*

The second principal approach to analyze the enforceability of no-hires is to analogize the no-hire provision to a restrictive covenant and apply state law governing enforceability of those agreements.[88] Since restrictive covenants are a matter of state law, the enforceability of no-hires varies from state to state. Specifically, enforceability depends on the state's interpretation of "reasonableness."[89] Generally, the reasonableness inquiry emphasizes the potential harm to the individual and requires limits on geographic scope, duration, and on the type of activities being restricted.[90] Additionally, most states also require that the agreement be reasonably necessary to protect an employer's legitimate protectable interests.[91] Protectable interests are typically described as being confidential, competitively valuable (i.e., trade secret) information and customer contacts or goodwill.[92] As previously mentioned, this approach leads to more agreements being held unenforceable.

The body of law regulating restrictive covenants is largely concerned with non-competition agreements. In many states, these types of agreements are carefully scrutinized by courts because of their restrictive effect on an individual's ability to earn a livelihood.[93] The rigor of the scrutiny applied highlights the two legal policies underlying this article.

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[84] *Id.* at 710.
[85] *Id.* at 714.
[86] *Id.* at 718.
[87] *Id.* It is important to note that although this provision was struck down, the Court was careful to state that reasonably limited restrictions that tend to promote trade may be enforceable. Furthermore, while the previous three cases mentioned provide examples of courts refusing to enforce no-hire agreements because of their effects as a restraint of trade, many jurisdictions uphold virtually identical agreements according to the same restraint of trade rationale.
[88] Haase & Mungerson, *supra* note 11, at 278.
[89] Roger T. Brice & Burton L. Reiter, *Drafting Employment-Related Agreements*, *in* LIT. & ADMIN. PRAC. COURSE HANDBOOK SERIES, 762 PRAC. L. INST. 215, 227 (2007).
[90] *Id.* at 229.
[91] *Id.*
[92] *Id.* at 227.
[93] Brice & Reiter, *supra* note 89, at 227.

While every state acknowledges the importance of enforcing these agreements in certain situations, some courts are more protective of employers' rights, and others of employees' rights.[94] Illinois, California and Georgia are three prime examples of states that are exceedingly wary to enforce noncompetition agreements.[95] In California, for example, post-employment noncompetition agreements are essentially prohibited by statute.[96] Georgia has also taken a unique approach: "under Georgia law, [the] level of scrutiny applied to a covenant not to compete depends on whether it is ancillary to the sale of a business or ancillary to employment."[97] If the agreement is ancillary to the sale of a business, the level of scrutiny is lower and objectionable portions may be "blue-penciled."[98] If the covenant is ancillary to employment, Georgia law is much more protective of employee rights; the courts apply strict scrutiny and refuse to blue-pencil objectionable provisions, instead holding the entire agreement unenforceable.[99]

There are two primary justifications for an employee protective rationale: (1) employees should be free to bargain for their labor, and (2) there is a public policy interest in maximizing available services.[100] However, even in states like Georgia that are highly protective of workers' rights, a carefully drafted agreement that is reasonable in duration, scope and necessary to protect the employer will most likely be enforceable.[101]

There are several different approaches that states may take if they determine that a covenant is overbroad. Depending on the state, the agreement will be: "(a) held invalid, (b) modified and enforced to the extent it is reasonable, or (c) modified and enforced only if and to the extent the overbroad portions can be 'blue-penciled.'"[102] Blue-penciling is a process where a court will modify an unenforceable agreement to the extent necessary to render it enforceable.

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[94] *See generally* John Dwight Ingram, *Covenants Not to Compete*, 36 AKRON L. REV. 49, 50 (2002).
[95] Brice & Reiter, *supra* note 89, at 229.
[96] *Id.*; *See* CAL. BUS. & PROF. CODE § 16600 (2008).
[97] Palmer & Cay, Inc. v. Marsh & McLennan Cos., 404 F.3d 1297, 1303 (11th. Cir. 2005).
[98] *Id.*
[99] *Id.*
[100] Ingram, *supra* note 94, at 49-50.
[101] Jeffrey Klein, Amy M. Rubin & Kenneth P. Gavsie, *Drafting Employment-Related Agreements*, *in* LIT. & ADMIN. PRAC. COURSE HANDBOOK SERIES, 762 PRAC. L. INST. 143, 184 (Oct. 2007).
[102] Brice & Reiter, *supra* note 89, at 228.

1. Applying the Restrictive Covenant Approach to Mergers & Acquisitions

Similar to both the antitrust and restraint of trade approaches, most states applying the restrictive covenant approach are highly protective of no-hires executed ancillary to the sale of a business. However, at least one court has struck down such an agreement as unreasonable and thus unenforceable under state restrictive covenant law.[103] The no-hire provision at issue was executed as part of a confidentiality agreement pursuant to a proposed sale of Pactiv's subsidiary to Menasha.[104] Pactiv required Menasha to sign the no-hire before it would provide any access to the financial information of the subsidiary.[105] The restriction applied for three years to all management-level employees worldwide at more than 100 direct or indirect subsidiaries of Pactiv, plus any future subsidiaries or divisions that might one day be established.[106]

The agreement was executed in April of 2000.[107] Pactiv brought suit following Menasha's hiring of a former Pactiv employee in July 2002.[108] Pactiv claimed that the agreement was not subject to Illinois law governing restrictive covenants because the agreement was executed pursuant to a confidentiality agreement, as opposed to a non-competition agreement.[109] The court rejected this argument, concluding, "The public policy implications of these restrictive covenants are identical."[110]

Since the no-hire provision constituted a restrictive covenant, the court then applied Illinois law to determine its enforceability.[111] To be enforceable under Illinois law, the restrictive covenant must be "reasonable in geographical and temporal scope and necessary to protect a legitimate business interest of the employer."[112] Additionally, the court considered its effect upon the general public, and the hardship imposed upon the party not seeking enforcement.[113] Ultimately, the court determined that the geographical limitations and scope were overly broad, encompassing more than necessary to protect Pactiv's legitimate business interests.[114] The court then noted that although Pactiv had a legitimate interest in preventing Menasha from misusing confidential information, Pactiv had not

[103] Pactiv Corp. v. Menasha Corp., 261 F.Supp.2d 1009, 1014 (N.D. Ill. 2003).
[104] *Id.* at 1011.
[105] *Id.*
[106] *Id.*
[107] *Id.*
[108] *Id.* at 1012.
[109] *Pactiv*, 261 F.Supp.2d at 1012.
[110] *Id.* at 1013.
[111] *Id.*at 1012.
[112] *Id.* at 1013 (citing Woodfield Group v. DeLisle, 295 Ill. App. 3d 935, 937 (Ill. App. Ct. 1998)).
[113] *Pactiv*, 261 F.Supp.2d at 1013.
[114] *Id.* at 1014.

demonstrated the necessity of a three year ban on hiring any employees worldwide.[115]

At the outset of the trial Pactiv requested that, if found unenforceable, the court blue-pencil the agreement to the extent necessary to render it enforceable.[116] In support of this request, Pactiv referenced the severability clause in the agreement, which provided that if any portion of the agreement was unenforceable, it should be disregarded and the remaining portions should be enforced.[117] Under Illinois law, a court has the discretion to choose to blue-pencil an agreement, or the court may strike down the agreement entirely.[118] When a court is considering whether to blue-pencil an agreement, "the fairness of the restraint initially imposed is a relevant consideration for the court in deciding whether to modify the restraining provision."[119] Furthermore, pursuant to Illinois law, the court should consider the potential adverse impact of modification, which is to discourage "narrow and precise draftsmanship"[120] by allowing businesses to draft overbroad restrictions and rely on the court to modify such restrictions to the extent necessary to be enforceable. Upon analysis of these considerations, the Illinois court declined to blue-pencil the agreement.[121]

This case is significant for two reasons. First, it is the only case this author discovered where a no-hire executed ancillary to the sale of a business was found to be unenforceable. As previously discussed, almost every court will appreciate the economic necessity of such agreements, provided the restrictions are reasonable. This introduces the second point: the restrictions in *Pactiv* were excessive—they applied for three years to all management-level employees worldwide at more than 100 subsidiaries, plus any future subsidiaries or divisions that might be established.[122] The fact that the court refused to blue-pencil the agreement, despite the severability clause, suggests that the Court sought to teach Pactiv a lesson, as opposed to expressing an opinion about the enforceability of such clauses in general.

2. Applying the Restrictive Covenant Approach to Employee Staffing Contracts

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[115] *Id.* at 1015.
[116] *Id.*
[117] *Id.* at 1016.
[118] *Id.* at 1015 (citing Arpac Corp v. Murray, 226 Ill. App. 3d 65, 80 (1st Dist. 1992)); *See also* Corroon & Black of Illinois, Inc. v. Magner, 145 Ill. App. 3d 151, 166 (1st Dist. 1986).
[119] *Pactiv*, 261 F.Supp.2d at 1015 (citing *Arpac*, 226 Ill. App. 3d at 79-80).
[120] *Pactiv*, 261 F.Supp.2d at 1015 (citing Eichmann v. Nat'l Hosp. & Health Care Servs., 308 Ill. App. 3d 337, 348 (Ill. App. Ct. 1999)).
[121] *Pactiv*, 261 F.Supp.2d at 1017.
[122] *Id.*

Parties challenging the enforcement of no-hires have experienced more success when the no-hire was executed pursuant to a contractual arrangement with other employers, compared with those executed ancillary to the sale of a business. The difficulty in enforcing these types of agreements again reflects the tension between the two underlying legal principles–the right of employees to accept jobs of their choice and the right of employers to protect their assets and remain free from unfair competition.[123]

This tension is compounded by the fact that the affected employees often do not have notice of the no-hires executed by their employers. The Wisconsin Supreme Court addressed this issue in 2002,[124] and their holding sent a chilling message to many employers. The case involved an agreement between plaintiff Heyde, the owner of Greenbriar Rehabilitation, a provider of physical therapists to nursing home facilities, and defendant Dove Healthcare, a nursing home operator.[125] The two companies executed a no-hire that restricted Dove from hiring any employee of Greenbriar during the course of the agreement and for one year thereafter.[126] The agreement also called for liquidated damages equal to fifty percent of the hired employee's annual salary, in the event the no-hire was breached.[127] Shortly after the agreement terminated, Dove breached the no-hire, extending employment to one current and three former employees of Greenbriar.[128] Greenbriar sued to obtain liquidated damages pursuant to the contract.[129]

The Wisconsin Supreme Court defined the issue as "whether a no-hire provision contained in a contract between employers, without the knowledge and consent of the affected employees, is unenforceable as an unreasonable restraint of trade."[130] It is important to note that although the court framed the issue as involving a restraint of trade, they analyzed the case under Wis. Stat. §103.465, which deals with restrictive covenants in employment contracts.[131] Greenbriar vehemently contested the application of this code section, because the agreement was between employers and Wis. Stat. § 103.465 refers to agreements between an employer and an employee.[132] However, the court rejected this argument, citing the purpose of the code section–to invalidate covenants that impose unreasonable

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[123] Wright, *supra* note 4, at 89.
[124] Heyde Companies, Inc. v. Dove Healthcare, LLC, 654 N.W.2d 830 (Wis. 2002).
[125] *Id.* at 832.
[126] *Id.*
[127] *Id.*
[128] *Id.*
[129] *Id.*
[130] *Heyde*, 654 N.W.2d at 833.
[131] *Id.*. However, it is possible that the Court may have viewed it as a restrictive covenant out of necessity because the state lacked an appropriate restraint of trade statute; *see also* Wis. Stat. § 103.465 (2002).
[132] *Heyde*, 654 N.W.2d at 833-34; *see also* WIS. STAT. § 103.465.

restraints on employees, regardless of how they are formed or what they are called.[133]

The court then applied a five-factor reasonableness analysis to determine enforceability.[134] To be enforceable the "covenant must: (1) be necessary to protect the employer; (2) provide a reasonable time limit; (3) provide a reasonable territorial limit; (4) not be harsh or oppressive to the employee; and (5) not be contrary to public policy."[135] Applying this test, the court concluded that the covenant failed to meet several criteria.[136] First, the agreement was not necessary because Heyde could have protected its interest by requiring its employees to sign a covenant not to compete.[137] Second, the court determined that the contract was harsh and oppressive to the employees.[138] Third, the contract was contrary to public policy.[139] The employees had no knowledge of the agreement entered into by their employer, and they were never asked to sign a non-compete.[140] In addition to the lack of knowledge, the Court suggested that the lack of consideration offered in exchange for the restriction was problematic.[141] Ultimately, this case is a troublesome sign for employers seeking to enforce no-hires in Wisconsin, and a foreboding signal to employers in other states whose courts have yet to specifically address the issue.

In addition to the plain message of the holding, this case is important in another regard. The case suggests that notice to the employee may be a prerequisite to enforceability in some states.[142] This would effectively require employers to execute non-competes with all of their employees, instead of no-hires with other businesses. Alternatively, if the no-hire is to be enforceable without an employer/employee non-compete, it suggests that the employer may be required to offer the employee adequate consideration in exchange for the restriction on her rights.[143] While the impact of this case is yet to be seen on a national level, Illinois has specifically rejected the conclusion of the Wisconsin Supreme Court,[144] and the Virginia Supreme Court expressed a contrary approach and result when

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[133] *Heyde*, 654 N.W.2d at 834.
[134] *Id.* at 835.
[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] *Id.* at 836.
[139] *Heyde*, 654 N.W.2d at 836.
[140] *Id.*
[141] *Id.*
[142] *See id.* at 838-39.
[143] Haase and Mungerson, *supra* note 11, at 301.
[144] H&M Commercial Driver Leasing, Inc. v. Fox Valley Containers, Inc., 209 Ill. 2d 52, 60-64 (Ill. 2004).

faced with a similar contractual provision several years prior to the Wisconsin decision.[145]

After the decision of the Wisconsin Supreme Court, the Supreme Court of Illinois rejected the Wisconsin approach when faced with a factually similar case. The case involved a no-hire agreement between plaintiff H&M, a lessor of truck driving services, and defendant Fox Valley Containers.[146] The agreement prohibited Fox Valley from hiring any drivers supplied by H&M for the duration of the contract, and for one year thereafter.[147] In the event of a breach, the agreement called for liquidated damages of $15,000, as well as attorney fees.[148] Subsequently, Fox Valley breached the agreement, and H&M sued for enforcement.[149]

The court considered the approaches of both the Virginia Supreme Court and the Wisconsin Supreme Court, and determined that the former was the proper approach.[150] To reach this conclusion, the court characterized the agreement as a restraint of trade, and explicitly rejected the characterization as a restrictive covenant.[151] For an agreement that operates as a restraint of trade to be enforceable under Illinois law, the provision must be: (1) reasonable, (2) not injurious to the public, (3) not cause undue hardship upon the affected individual, and (4) the restraint is not greater than necessary to protect the promisee.[152] The court then determined that the provision was reasonable to protect H&M's sole business assets, its drivers, from being poached by customers.[153] Furthermore, the court pointed out that H&M drivers were free to seek employment with any employer except Fox Valley, and that if Fox Valley desperately wanted a certain employee and could not wait for one year, they could elect to pay liquidated damages.[154] Furthermore, the provision was narrowly tailored because Fox Valley was not precluded from hiring all H&M employees, rather the agreement covered only those employees who had been provided to Fox Valley by H&M.[155] The court then determined

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[145] Therapy Services, Inc. v. Crystal City Nursing Center, Inc., 389 S.E.2d 710 (Va. 1990). Holding that such an agreement was not a restrictive covenant, but rather a contract in restraint of trade. As such, the court determined it would be upheld unless it was found to be unreasonable or injurious to society. The Court then determined the agreement was enforceable, because it was reasonable to protect the interests of the employer and was not injurious to the public.

[146] *H&M Commercial Driver Leasing*, 209 Ill. 2d at 54.

[147] *Id.* at 54.

[148] *Id.*

[149] *Id.* at 55.

[150] *Id.* at 60-64.

[151] *Id.*

[152] *H&M Commercial Driver Leasing*, 209 Ill. 2d at 64; *see also* Bauer v. Sawyer, 134 N.E.2d 329 (Ill. 1956).

[153] *H&M Commercial Driver Leasing*, 209 Ill. 2d at 64.

[154] *Id.*

[155] *Id.*

that the provision was not injurious to the public, because there was no data suggesting that the availability of truck drivers in the area was diminished.[156] Lastly, there was no evidence that the provision inflicted undue hardship on the employees.[157] For all of these reasons, the Illinois Supreme Court upheld the enforceability of the agreement.[158]

It is interesting to note the specificity of the analysis the court employed to reach their decision. Most importantly, the court noted that there was no data to suggest that the availability of truck drivers in the area was diminished.[159] This dictum seems to leave open the opportunity to challenge a similar case in the future, especially one involving larger companies with greater potential to affect the availability of services in a given market.

The Illinois Supreme Court was also careful to distinguish a similar case from the Illinois Appellate Court, *Szabo Food Service v. Cook County*, which recognized an exception to enforceability.[160] In that case, Szabo entered into a contract with Cook County to provide food service managers for the county jail.[161] The contract contained a provision that restricted Cook County from hiring or otherwise employing any of Szabo's managerial employees during the contract, as well as for a period of six months following termination of the contract.[162] After the contract terminated, Cook County hired the Canteen Corporation to handle food services at the jail.[163] Shortly thereafter, the Canteen Corporation hired four former managers of Szabo to work at the jail.[164] Subsequently, Szabo sought an injunction to prevent Canteen Corporation from employing the four former Szabo managers at the jail.[165] In its complaint, Szabo alleged that it had established three rights in need of protection: (1) the right to have the covenant enforced, (2) the right to protect the confidential information its managers acquired, such as specialized procedures, systems, methods and data, and (3) the right to retain its employees without malicious interference from its competitors.[166]

The Illinois court began its analysis by characterizing the agreement as a restrictive covenant.[167] Next, the court stated the general rule that, "courts will enforce a restrictive covenant only if its impact on the

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[156] *Id.*at 64-65.
[157] *Id.* at 65.
[158] *Id.*
[159] *H&M Commercial Driver Leasing*, 209 Ill. 2d at 64-65.
[160] Szabo Food Service, Inc. v. Cook County, 160 Ill. App. 3d 845 (1987).
[161] *Id.* at 846.
[162] *Id.*
[163] *Id.*
[164] *Id.* at 846-47.
[165] *Id.* at 847.
[166] *Szabo Food Service*, 160 Ill. App. 3d at 848.
[167] *Id.* at 848.

parties to the contract and the public is reasonable."[168] The critical issue in this case was that along with restricting the rights of the county, the covenant also restricted Canteen Corporation from hiring former Szabo managers to work at the jail.[169] Regarding Szabo's first claim, neither Canteen Corporation nor the Szabo managers were parties to the initial contract.[170] As such, the court determined that the covenant created an unreasonable restriction on the freedom of contract of both parties, and Szabo had no right to enforce the covenant.[171] The court quickly dismissed Szabo's second claim as well, noting that even if it could prove the existence of confidential information, Szabo did not treat this information as confidential, because they had not taken reasonable means to protect the information, such as executing restrictive covenants with the managers.[172] Finally, the third claim was also dismissed, because to succeed in a claim for tortious interference, Szabo was required to demonstrate that it would be irreparably injured by lack of enforcement, and the court found that there was no such irreparable injury.[173]

III. THE POTENTIAL FOR FORUM SHOPPING

In 2005, a case decided by the United States Court of Appeals for Eleventh Circuit set a troublesome precedent for parties seeking enforcement of no-hires.[174] The dispute involved the enforceability of a covenant not to compete between a company with a multi-state presence and an employee.[175] The employee challenging enforceability brought suit in Georgia to take advantage of Georgia's pro-employee laws regarding the enforceability of such agreements.[176] The importance of the decision is that not only did the Eleventh Circuit determine that the agreement was unenforceable under Georgia law, but the Court also held that the unenforceability extended to any other lawsuit between the parties, even lawsuits filed outside of Georgia.[177] In other words, an employee seeking to challenge enforceability may fare well simply by rushing to Georgia to challenge the restriction (assuming jurisdiction can properly be obtained in

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[168] *Id.*; *see also* Junkunc v. S. J. Advanced Technology & Mfg. Corp., 498 N.E.2d 1179 (Ill. App. 3d 1986).
[169] *Szabo Food Service*, 160 Ill. App. 3d at 848.
[170] *Id.*
[171] *Id.* at 849.
[172] *Id.* at 849-50.
[173] *Id.* at 850.
[174] *Palmer & Cay*, 404 F.3d at 1297.
[175] *Id.* at 1303.
[176] Don Benson & Stephanie Bauer Daniel, *New Race to Tennessee and Georgia Courthouses Over Non-Competition Agreements*, 41 TENN. B.J. 18, 18 (Oct. 2005) (Georgia has a strong public policy that disfavors restraints on trade and is one of the most difficult states in which to enforce such an agreement).
[177] *Id.* at 25.

Georgia).[178] If the employee is successful, the claim and issue preclusive effect of the ruling may prevent the employer from enforcing the agreement in other jurisdictions as well.[179] This case could be extremely troublesome for employers with connections to Georgia or employers whose employees could otherwise obtain proper jurisdiction in Georgia.[180]

IV. CONCLUSION

Moving forward, it appears likely that the majority of courts that address no-hires will continue to interpret them as contracts in restraint of trade or restrictive covenants. A party seeking enforcement will generally prefer the court to use the former. The exception to this general rule arises when a state has a statute that essentially prohibits contracts in restraint of trade, but permits some restrictive covenants, such as South Dakota.[181]

Despite the prevalence of the contracts in restraint of trade and restrictive covenants approaches, several cases recently decided in the Third and Seventh Circuit Courts of Appeals have suggested that the antitrust approach may once again be a viable option to contest enforcement of no-hires.[182] Although the no-hires in both *Eichorn* and *Deich-Keibler* were enforced, both circuits determined the employee had standing to sue under antitrust laws and carefully scrutinized the claims.[183] Under the right circumstances, it may be worthwhile to challenge enforceability under the antitrust approach.[184]

Regardless of the approach, almost every court will enforce a no-hire provision executed ancillary to the sale of a business.[185] Courts recognize that a rational buyer will be wary to invest if her targeted asset, human capital, could disappear shortly after the close of the transaction.[186] The only exception to this general rule that this author has discovered involved a no-hire provision that contained excessive prohibitions.[187]

On the other hand, parties have had less success enforcing no-hires in situations where one company executes a contract to provide employees

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[178] *Id.*

[179] *Id.* at 24-25; *See Palmer & Cay*, 404 F.3d at 1310.

[180] Benson & Daniel, *supra* note 176, at 25; *See Palmer & Cay*, 404 F.3d at 1310.

[181] *Densmore*, 583 N.W.2d at 125; Haase & Mungerson, *supra* note 11, at 295.

[182] *Eichorn*, 248 F.3d at 131; *Deich-Keibler*, 243 Fed.Appx. at 164.

[183] *Eichorn*, 248 F.3d at 131; *Diech-Keibler*, 243 Fed.Appx. at 164.

[184] A good case to challenge enforceability under the antitrust approach would involve a provision that could potentially restrict a large number of employee's rights and negatively impact the availability of services in a given industry. The argument against enforceability is stronger as the potential anti-competitive effect on the industry increases. Similarly, lack of notice to the affected parties may strengthen the argument in some jurisdictions.

[185] *See*, Henry & Miller, *supra* note 1, at 40.

[186] *Id.*

[187] *See Pactiv*, 261 F. Supp. 2d at 1011.

or services to another company. This has been true under both the restraint of trade approach[188] and the restrictive covenant approach.[189] Additionally, lack of notice to the affected employee(s) has been a critical factor in certain jurisdictions.[190] The *Heyde* case also suggested that a no-hire may not be enforceable if the employer could have protected its interest by requiring the employee to sign a non-compete.[191] Moving forward, it will be interesting to see if South Dakota applies this rigorous standard to cases involving no-hires executed ancillary to the sale of a business. The opinion seems to suggest as much,[192] but the matter is not squarely addressed and such an interpretation would be a stark departure from the general enforceability of no-hires executed ancillary to the sale of a business.

Finally, employers seeking to enforce no-hires should be aware of the decision by the Eleventh Circuit regarding the potential for plaintiffs to forum shop.[193] After *Palmer & Cay*, a party seeking to challenge enforceability may fare well simply by rushing to Georgia to challenge the restriction, taking advantage of Georgia's pro-employee laws regarding enforceability.[194] Employers that could be subject to jurisdiction in Georgia should be wary of this foreboding Eleventh Circuit decision.

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[188] *See Densmore*, 583 N.W.2d at 125; *Club Properties*, 348 S.E.2d at 919; *VL Systems*, 152 Cal. App.4th at 708.
[189] *Heyde*, 654 N.W.2d at 830.
[190] *See, e.g. Densmore*, 583 N.W.2d at 128.
[191] *See Heyde*, 654 N.W.2d at 831.
[192] *See id.* at 831, 838-39.
[193] *See Palmer & Cay*, 404 F.3d at 1297.
[194] Benson & Daniel, *supra* note 176, at 25; *See, Palmer & Cay*, 404 F.3d at 1297.