

# Employee Non-competes and Consideration: A Proposed Good Faith Standard for the “Afterthought” Agreement

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## I. INTRODUCTION

### A. *The Case of Runzheimer International*

It is estimated that more than fourteen million Americans are currently employed in a sales or sales-related occupation.<sup>1</sup> The highest paid professionals within these occupations are Sales Engineers, Financial Services Agents, Wholesale and Manufacturing Sales Representatives, Insurance Sales Agents, and Advertising Sales Agents.<sup>2</sup> The companies that employ these professionals have incentives to keep their top producers by creating compensation programs or providing “sales bonuses.” These companies also have incentives to deter their top producers from migrating to their competitors. While not exclusive to the sales industry, it is common for companies to feel the pressures of market competition and subsequently ask their employees to sign non-compete agreements—oftentimes long after the employees already have started working.<sup>3</sup>

In Wisconsin, the enforceability of such a non-compete was played out in the courts in a battle between Runzheimer International (Runzheimer) and Corporate Reimbursement Services, Inc. (CRS), two of the largest companies that provide vehicle reimbursement programs for employers.<sup>4</sup> David Friedlen worked for Runzheimer in a sales position for fifteen years when he was presented with a restrictive

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1. *Occupational Employment Statistics: Sales and Related Occupations*, BUREAU LAB. STAT., <http://www.bls.gov/OES/current/oes410000.htm> (last modified Mar. 25, 2015).

2. *Occupational Outlook Handbook: Sales Occupations*, BUREAU LAB. STAT. (Jan. 8, 2014), <http://www.bls.gov/oooh/sales/home.htm>.

3. See *infra* Part IV.A–G and accompanying text.

4. See *Runzheimer Int'l, Ltd. v. Friedlen*, 862 N.W.2d 879 (Wis. 2015).

covenant.<sup>5</sup> Upon threat of discharge, he signed the two-year non-compete agreement in 2009.<sup>6</sup> Two years later, Runzheimer fired him, and in 2012, Friedlen joined CRS in a sales role.<sup>7</sup>

In Runzheimer's suit against both Friedlen and CRS, the primary issue was whether "consideration in addition to continued employment [is] required to support a covenant not to compete entered into by an existing at-will employee."<sup>8</sup> The trial court concluded that the promise of continued employment was an illusory promise "because Runzheimer retained 'the unfettered right to discharge Friedlen at any time, including seconds after Friedlen signed the Agreement.'"<sup>9</sup> "[H]olding otherwise would allow an employer to obtain valuable rights from an employee on the promise of continued employment, but terminate the employee seconds after he signed the agreement. The result would be that the employee 'is bound by a non-compete in exchange for nothing in return.'"<sup>10</sup> The Wisconsin Court of Appeals, finding Wisconsin law on the issue unclear, certified the question to the Wisconsin Supreme Court for resolution.<sup>11</sup>

Before the Wisconsin Supreme Court, Runzheimer contended that there should be no difference in how courts treat non-compete agreements entered into at the beginning of employment from those entered into after years of employment because, in either case, "the employer is promising employment," and the continued employment constitutes the consideration for a non-compete signed by an existing employee.<sup>12</sup> Friedlen countered that unlike the initial employment, which involves an exchange of "detriments and benefits," an existing employee who signs a non-compete is in the same position before and after the covenant is executed.<sup>13</sup> Thus, the employer provides no legal benefit nor suffers any legal detriment, the hallmarks of consideration, and the agreement is unenforceable without some consideration in

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5. *Id.* at 882–83.

6. *Id.* at 883.

7. *Id.* at 883–84.

8. *Runzheimer Int'l, Ltd. v. Friedlen*, No. 2013AP1392, 2014 WL 1465157, at \*1 (Wis. Ct. App. Apr. 15, 2014), *rev'd*, 862 N.W.2d 879 (Wis. 2015).

9. *Runzheimer*, 862 N.W.2d at 882.

10. Response Brief of Defendants-Respondents at 20–21, *Runzheimer Int'l, Ltd. v. Friedlen*, No. 2013AP1392, 2014 WL 1465157 (Wis. Ct. App. Apr. 15, 2014), 2013 WL 6218982, at \*19–20 [hereinafter Response Brief of Defendants-Respondents] (internal citations omitted), *rev'd*, 862 N.W.2d 879 (Wis. 2015).

11. *Runzheimer*, 862 N.W.2d at 884.

12. *Id.* at 885–86.

13. *Id.* at 886.

addition to continued employment.<sup>14</sup>

The Wisconsin Supreme Court appeared to be sensitive to the change in an employee's bargaining position after employment has commenced.

Runzheimer appears to minimize the vulnerable position of an employee who has worked for the same employer for a number of years. The employee may develop specialized skills and knowledge that would transfer smoothly to an equivalent position for another employer—except for the newly established restrictive covenant. These skills and knowledge may not transfer so easily when a new position involves a different line of work. Moreover, the employee may have grown much older and acquired family responsibilities not present when the employee was hired. The inability to transfer easily to an equivalent job may reduce the employee's bargaining power to negotiate a raise or bonus with the initial employer and may prevent the employee from terminating the employment relationship on his own timetable. By contrast, an employee at the beginning of the employment relationship is likely to have more freedom to find alternative employment because he or she may not be burdened with some of these restraints.<sup>15</sup>

Nevertheless, the *Runzheimer* majority held that an employer's forbearance from terminating an employee is sufficient consideration for a non-compete covenant.<sup>16</sup> Rather than rely on continued employment as consideration, the court reasoned: "Runzheimer's promise not to fire Friedlen if he signed the covenant was not illusory because it was not a promise implicating Runzheimer's future discretionary conduct. Rather, Runzheimer's promise was that it would not fire Friedlen *at that time and for that reason.*"<sup>17</sup>

Like many courts that address this issue, the Wisconsin court was apparently troubled by the implications of its forbearance rationale—that is, that an employer could immediately terminate an employee after a non-compete agreement was executed because there is no enforceable obligation of continued employment for any period of time.<sup>18</sup> Struggling to find a limiting principle, the majority reasoned that an employee under such circumstances would have a remedy for fraud or breach of the covenant of good faith and fair dealing.<sup>19</sup>

In a concurring opinion by then-Chief Justice Shirley Abrahamson,

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14. *Id.*

15. *Id.*

16. *Id.* at 882.

17. *Id.* at 890.

18. *Id.* at 891–92.

19. *Id.*

the obvious flaw in the court's logic was revealed. The employer promising not to *immediately* discharge makes no false statement, and without a misrepresentation, a claim of fraud would fail.<sup>20</sup>

If all Runzheimer promised was to forbear from immediately terminating Friedlen's at-will employment, on what basis could Friedlen assert a breach of the covenant of good faith and fair dealing had Runzheimer fired Friedlen shortly after he signed the covenant not to compete? The answer seems to be none. An at-will employment contract specifically authorizes the employer to fire the employee at any time and for any reason.<sup>21</sup>

Justice Abrahamson asserted that a promise by Runzheimer to refrain from firing Friedlen for a "reasonable time" after Friedlen signed the agreement would make the consideration valid and not illusory, and she read the majority opinion to so hold.<sup>22</sup>

### B. Article Overview

In their seminal article on employee non-compete agreements, Professors Jordan Leibman and Richard Nathan coined the phrase *afterthought agreement* to describe non-compete covenants executed after an at-will employee has commenced employment.<sup>23</sup> As in *Runzheimer*, employees are frequently presented with and sign non-compete agreements after their initial hiring and after their employment contracts have already been established.<sup>24</sup> Under contract law principles, the issue in afterthought cases is what constitutes sufficient consideration for the employee's promise not to compete—an issue that has confounded the courts.<sup>25</sup>

Policy issues permeate the afterthought agreement because of the potential abuse of bargaining power by employers.<sup>26</sup> An employee's bargaining power is substantially diminished after employment has commenced, and the threat of discharge is a potent weapon that

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20. *Id.* at 895 (Abrahamson, C.J., concurring).

21. *Id.* at 896.

22. *Id.* at 896–97.

23. Jordan Leibman & Richard Nathan, *The Enforceability of Post-Employment Noncompetition Agreements Formed After At-Will Employment Has Commenced: The "Afterthought" Agreement*, 60 S. CAL. L. REV. 1465, 1472 (1987).

24. *See id.*

25. *See id.* at 1473.

26. *See id.* at 1548–49.

employers can use to secure an afterthought agreement.<sup>27</sup> Courts have struggled to provide an effective check on this potential abuse of the employer's superior bargaining position in the afterthought context.

A lack of transparency and failure to disclose non-compete requirements during pre-employment negotiations is another concern with afterthought agreements. One commentator has characterized a form of afterthought agreement as a *cubewrap contract*, where an employer presents a non-compete agreement to new hires shortly after employment has already been agreed to and commenced.<sup>28</sup> This practice involves "springing" non-compete agreements on unsuspecting employees after the original terms of their employment have been negotiated and after their employment has started.<sup>29</sup> Empirical evidence suggests this practice may be strategy-based: some firms wait until after employees have started working to present non-compete agreements, thereby leveraging the employee's weaker bargaining position to secure consent.<sup>30</sup> Our analysis of the afterthought context will include, but is not restricted to, the *cubewrap contract* scenario.

Because of its significance from doctrinal and public policy perspectives, the issue of the afterthought agreement has spawned scholarly examination, with commentators suggesting alternative approaches to its resolution.<sup>31</sup> The courts are also similarly divided on the issue. The majority holds that continued employment is sufficient consideration for the employee's promise not to compete; thus, no new

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27. *See id.* at 1543.

28. Rachel Arnow-Richman, *Cubewrap Contracts and Worker Mobility: The Dilution of Employee Bargaining Power Via Standard Form Noncompetes*, 2006 MICH. ST. L. REV. 963, 966 (2006) (coining the "cubewrap" contracts phrase). The phrase *cubewrap contracts* refers to non-compete agreements presented to employees—or left in their cubicles—after the employee has already accepted the employment offer and started work; this situation is analogous to the delayed disclosure of license terms under "shrinkwrap" agreements. *Id.* at 977–78.

29. Rachel Arnow-Richman, *Cubewrap Contracts: The Rise of Delayed Term, Standard Form Employment Agreements*, 49 ARIZ. L. REV. 637, 640–41 (2007) [hereinafter Arnow-Richman, *Delayed Term*] (arguing for mandatory pre-employment disclosure of non-compete agreements).

30. Matt Marx, *The Firm Strikes Back: Non-compete Agreements and the Mobility of Technical Professionals*, 76 AMER. SOC. REV. 695, 700, 705–06 (2011) (finding, in a survey of 1,029 engineers and interviews with 52 patent holders in automatic speech recognition industry, that non-compete was included with the employment offer fewer than one-third of the time and that employees not presented with non-compete at time of offer were less likely to have a lawyer review the non-compete terms).

31. *See* Leibman & Nathan, *supra* note 23, at 1573–74 (arguing for state statutes requiring that afterthought agreements be in writing, that employees not be subject to discharge for refusing to sign such agreements, but no new consideration should be necessary). *See also* Kathryn J. Yates, Note, *Consideration for Employee Noncompetition Covenants in Employments At Will*, 54 FORDHAM L. REV. 1123, 1137–39 (1986) (arguing that continued employment is sufficient consideration based on unilateral contract approach to issue).

consideration is necessary.<sup>32</sup> This pragmatic view aligns with the traditional, employment-at-will doctrine. The minority rule, on the other hand, requires “independent” or “separate” consideration such as a promotion, pay raise, or other consideration in addition to the employer’s promise of continued at-will employment.<sup>33</sup> This strict contract law approach is consistent with the traditional judicial disfavor of employee non-compete agreements and in line with the common law pre-existing duty rule.

We offer an alternative approach to the consideration issue in the afterthought context. Neither the majority nor the minority rule provides standards that directly address the fundamental problem with the afterthought agreement, nor do they adequately address the balance of competing employer, employee, and societal interests. The majority approach allows the employer the flexibility to alter the terms of the employment contract to further the needs of a changing business. But this simple, practical solution comes at a serious cost to employees and open competition. Under the majority rule, employers may be able to exploit their bargaining position and “force” employees to agree to a non-compete agreement or otherwise unfairly use an afterthought agreement to stifle competition.

The minority rule’s requirement of independent consideration ensures that an afterthought agreement is mutually beneficial and presumably premised upon legitimate commercial interests of the employer. It also tempers the employer’s bargaining power by requiring additional consideration in exchange for the afterthought agreement. However, the rule is over-inclusive—even a truly voluntary afterthought agreement that is justified by an employee’s increased knowledge of trade secrets or contacts with clients is unenforceable if there is an absence of independent consideration. Thus, the minority rule is problematic because it fails to mitigate the potential exploitation of employers by employees who possess proprietary information, and it could conceivably permit unfair competition.<sup>34</sup>

We contend that from a policy standpoint, a good faith standard is preferable to either of the existing paradigms.<sup>35</sup> Unlike the majority rule, a good faith standard would preclude an employer from coercing an afterthought agreement or unfairly imposing a non-compete agreement

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32. See *infra* Part III.A.

33. See *infra* Part III.B.

34. See *infra* Part V.B and accompanying text.

35. See *infra* Part VI.

on an employee. The requirement of good faith would provide an important deterrent to employers who might otherwise seek to unfairly use their superior bargaining position. Additionally, a good faith requirement would provide a significant incentive for employers to be open and transparent during all stages of the negotiation process for an afterthought agreement. Although the existence of separate consideration would be considered in the good faith determination, employers would not be required to demonstrate independent consideration to enforce an afterthought agreement. The ultimate question would be one of good faith.

Drawing from modern contract law and non-compete law relating to the reformation of overbroad non-compete agreements, we propose a two-prong test for good faith.<sup>36</sup> The *substantive component* would consider the business justification for the afterthought agreement, including changes in the employment relationship and the extent to which the employer was seeking a non-compete covenant based on legitimate protectable interests in the protection of trade secrets or customer relationships. The *process component* of the good faith standard would consider the means by which the employer secured the employee's assent to the non-compete agreement, including whether the employee was apprised of the non-compete at the commencement of the relationship. Bad faith would be presumed if the employer threatened discharge or engaged in other coercive actions to secure the consent of the employee. Substantial consideration provided the employee in support of the afterthought agreement also would be considered in the good faith analysis but would not be determinative.

Part II of this Article provides an overview of the present state of the law on employee non-compete agreements. Parts III and IV discuss the majority and minority approaches to the consideration issue and analyze recent opinions of state supreme courts applying the two approaches. Part V provides a critical public policy analysis of the majority and minority positions. Part VI justifies our recommended approach to the consideration issue, and Part VII proposes a framework for determining good faith in the afterthought context.

## II. AGREEMENTS NOT TO COMPETE IN THE EMPLOYMENT CONTEXT

Employee non-compete agreements implicate legitimate interests of

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36. See *infra* Part VII.

employers, employees, and society.<sup>37</sup> Employers have a need to protect their trade secrets and business goodwill from misappropriation by former employees.<sup>38</sup> Although competition by former employees is inevitable, and non-compete agreements should not be the means by which open competition or new market entrants are stifled, employers have an interest in protecting the informational and relational interests of the firm.<sup>39</sup> Thus, preventing unfair competition through the improper exploitation of an employer's assets is the primary employer interest justifying restraints on post-employment competition.

Former employees have a legitimate property interest in their own human capital development.<sup>40</sup> They should be free to use the intellectual capital acquired at work in competition with their former employers, including the general knowledge, skills, and experience gained in the industry, so long as they do not misappropriate the employer's property rights.<sup>41</sup> Non-compete agreements implicate employee interests in mobility and professional advancement.<sup>42</sup>

Society has an interest in protecting intellectual property rights and in preventing unfair competition. The enforcement of employee non-compete agreements, particularly in the protection of trade secrets, is part of an intellectual property law regime that is designed to provide incentives for the commercial development of new products, services, and ideas.<sup>43</sup> Conversely, society needs to ensure that unnecessary barriers to entry into the marketplace are minimized to ensure a robust, competitive environment—the underlying driver of any capitalistic economy.<sup>44</sup> Moreover, society has an important interest in the efficiency

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37. This Article is an extension of our previous research and writing on employee non-compete agreements. See Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach*, 45 AM. BUS. L.J. 107 (2008). For a historical and policy discussion of employee agreements not to compete with employers after termination of employment, see Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625 (1960), and T. Leigh Anenson, *The Role of Equity in Employment Noncompetition Cases*, 42 AM. BUS. L.J. 1 (2005).

38. See Blake, *supra* note 37, at 653.

39. See Leibman & Nathan, *supra* note 23, at 1483–90.

40. See Katherine V.W. Stone, Commentary, *Knowledge at Work: Disputes over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 722 (2002).

41. See *id.* at 758, 763.

42. *Standard Brands, Inc. v. Zumpe*, 264 F. Supp. 254, 259 (E.D. La. 1967) (“[T]he employee . . . must be afforded a reasonable opportunity to change jobs without abandoning the ability to practice his skills.”).

43. See, e.g., Maureen B. Callahan, Comment, *Post-Employment Restraint Agreements: A Reassessment*, 52 U. CHI. L. REV. 703, 706–07 (1985).

44. *Reed, Roberts Assocs. v. Strauman*, 353 N.E.2d 590, 593 (N.Y. 1976) (“[O]ur economy is premised on the competition engendered by the uninhibited flow of services, talent and ideas.”).



of markets for scarce human resources.<sup>45</sup> To the extent that non-compete agreements impose unreasonable restrictions on labor mobility, they produce inefficient allocations within labor markets.<sup>46</sup> Thus, while non-compete agreements implicate conflicting societal interests in free and fair competition, the overriding policy concern is ensuring that competitive markets support and encourage innovation and entrepreneurship.

A. *The Development of the Law of Employee Non-compete Agreements*

Traditionally, the law of employee non-compete agreements was highly protective of the employee's right to free mobility.<sup>47</sup> Societal interests in free competition and open labor markets justified the suspicion of non-compete agreements.<sup>48</sup> Most courts examined non-compete agreements under a demanding reasonableness test that required employers to justify the necessity for and the reasonableness of any restriction on post-employment competition.<sup>49</sup> In other jurisdictions, state restraint-of-trade statutes limited or prohibited the enforceability of covenants not to compete.<sup>50</sup> Overall, the traditional legal environment was hostile to employee non-compete agreements, with courts carefully scrutinizing the "interests" sought to be protected by restrictive covenants and the "scope" of the restrictions necessary to protect those interests.

Over time, however, a gradual change occurred in the law, with many jurisdictions employing a more permissive approach to non-compete agreements than under the common law.<sup>51</sup> This gradual shift in the law in favor of employer interests—what we refer to as the "modern"

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45. *Standard Brands, Inc.*, 264 F. Supp. at 259.

[T]he employee who possesses the employer's most valuable confidences is apt to be highly skilled. The public is interested in the reasonable mobility of such skilled persons from job to job in our fluid society, which is characterized by and requires the mobility of technically expert persons from place to place, from job to job and upward within the industrial structure.

*Id.*

46. *See Blake, supra* note 37, at 627.

47. *See Garrison & Wendt, supra* note 37, at 113–22.

48. *Id.* at 114–15.

49. *Id.* at 110–11, 114–20.

50. *Id.* at 120–22.

51. *See id.* at 122–35. In his systematic analysis of state non-compete laws, Professor Bishara finds support for our finding of a "general increase in enforcement" in the United States under this modern approach. Norman D. Bishara, *Fifty Ways to Leave Your Employer: Relative Enforcement of Covenants Not to Compete, Trends, and Implications for Employee Mobility Policy*, 13 U. PA. J. BUS. L. 751, 780 (2011).

approach—has altered the traditional legal landscape. Courts have broadened both the category of protected employer interests and the permissible scope of employee non-compete agreements.<sup>52</sup> Courts have also been empowered to reform or rewrite the terms of unreasonable non-compete agreements so as to render them enforceable, thereby encouraging the use of broad standardized agreements.<sup>53</sup>

The most recent opinions on employee non-compete agreements reveal an emerging new trend in the law.<sup>54</sup> Many courts appear to be returning to the strict standards of the common law, adopting doctrines and rules that limit the enforceability of non-compete agreements. This heightened judicial scrutiny of employee non-compete agreements is founded on an overriding policy interest in protecting employee mobility and supported by evidence of the positive effects labor mobility may have on entrepreneurship and economic development, particularly in the increasingly critical information technology sector.<sup>55</sup>

The traditional academic view was that employee non-compete agreements are desirable from a macroeconomic perspective. Post-employment restraints were considered necessary to protect a firm's investment in its employees and firm knowledge.<sup>56</sup> By protecting trade secrets, such agreements provide an incentive for research and development and stimulate innovation.<sup>57</sup> And, by preventing unfair competition, non-compete agreements are essential to the proper functioning of an efficient marketplace.<sup>58</sup>

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52. See, e.g., *Saliterman v. Finney*, 361 N.W.2d 175, 178–79 (Minn. Ct. App. 1985) (citing *Cherne Indus., Inc. v. Grounds & Assocs.*, 278 N.W.2d 81, 92 (Minn. 1979) (holding that an injunction may be appropriate to protect confidential information even if the information is not a trade secret)).

53. *Garrison & Wendt*, *supra* note 37, at 130–31. For a discussion of the differing judicial approaches to overbroad non-compete agreements, see *infra* Part III.

54. See *Garrison & Wendt*, *supra* note 37, at 135–48 (summarizing decisions of state supreme courts from 1999–2006 having doctrinal significance to the law of employee non-competes).

55. See *id.* at 135–48, 164–73.

56. See *Callahan*, *supra* note 43, at 715 (“To the extent that inventors are prevented from reaping the benefits of the information they develop, they are discouraged from engaging in costly research and development, and competition will suffer because fewer products will be produced.”).

57. *Blake*, *supra* note 37, at 627.

From the point of view of the employer, postemployment restraints are regarded as perhaps the only effective method of preventing unscrupulous competitors or employees from appropriating valuable trade information and customer relationships for their own benefit. Without the protection afforded by such covenants, it is argued, businessmen could not afford to stimulate research and improvement of business methods to a desirably high level, nor could they achieve the degree of freedom of communication within a company that is necessary for efficient operation.

*Id.*

58. *Stone*, *supra* note 40, at 753–55.

Recent scholarly commentary from a broad range of disciplinary perspectives has challenged many of these classical assumptions about the beneficial impact of employee non-compete agreements. Management and law scholars have argued for greater legal protection for an employee's "human capital" than under the traditional view, arguments founded on changes in the modern employment relationship<sup>59</sup> and the need to provide a restraint on the unfair bargaining position of employers.<sup>60</sup>

Economists and other scholars have found that laws restricting employee non-compete agreements can actually increase innovation and entrepreneurial activity.<sup>61</sup> Strict enforcement of non-competes also discourages employees from investing in their own human capital and may have a detrimental impact on the level of R&D investments.<sup>62</sup> The tremendous success of the IT sector in Silicon Valley has been attributed in part to the hyper labor mobility and information sharing prevalent in the region, with some scholars asserting that California's prohibition on employee non-compete agreements facilitated that labor mobility and thus was a key driver in the rapid formation of new ventures in the region.<sup>63</sup> Given the recent evidence on the economics of non-competes

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59. See *id.* at 754–55 (arguing that under a new employment relationship that is characterized by lack of job security, employees should have substantial ownership rights to their "human capital").

60. See Kate O'Neill, 'Should I Stay or Should I Go?'—Covenants Not to Compete in a Down Economy: A Proposal for Better Advocacy and Better Judicial Opinions, 6 HASTINGS BUS. L.J. 83, 84 (2010) (arguing for non-compete enforcement to be dependent on employee's relative bargaining power). See also Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes*, 80 OR. L. REV. 1163, 1167–68 (2001) (arguing for a "formation-based model" for enforcement of non-compete agreements that considers bargaining positions and fairness of agreement; drawing analogy from judicial oversight of premarital agreements).

61. See Sampsa Samila & Olav Sorenson, *Noncompete Covenants: Incentives to Innovate or Impediments to Growth*, 57 MGMT. SCI. 425, 436 (2011) ("We find that the enforcement of noncompete covenants moderates the effects that venture capital has on both innovation and the overall regional economy. More specifically, our results imply that not only does the enforcement of noncompete agreements limit entrepreneurship, . . . but it also appears to *impede* innovation."). See also Deborah M. Weiss, *Entrepreneurial Employees* (Northwestern Univ. Sch. of Law; Univ. of Tex. at Austin Red McCombs Sch. of Bus., Working Paper Series, Aug. 9, 2011), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1868646](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1868646) (finding that laws restricting employee non-compete agreements can increase innovation in industries where small firms have an innovative advantage over large firms).

62. See Mark J. Garmaise, *Ties that Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment*, 27 J.L. ECON. & ORG. 376, 379, 408 (2011).

63. Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 578 (1999). "Silicon Valley's legal infrastructure, in the form of Business and Profession Code section 16600's prohibition of covenants not to compete, provided a pole around which Silicon Valley's characteristic business culture and structure precipitated." *Id.* at 609. Professor Gilson's thesis was

and the changing nature of the information-age employment relationship, scholars have developed proposals to reform employee non-compete law.<sup>64</sup>

Recently, employee non-compete agreements have come under political attack in a number of states, and restrictive legislation has been introduced in several of them. A policy debate over the desirability of such agreements has been ongoing for some time in Massachusetts,<sup>65</sup> and legislation is currently being considered that would render non-compete

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based on the groundbreaking work of AnnaLee Saxenian and her study of Silicon Valley. ANNALEE SAXENIAN, *REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128* (1994). She posited that the Valley's culture of labor mobility, information sharing, and entrepreneurial activity created the booming industrial district. *Id.* at 161–62. She argued that Silicon Valley was dominated by small firms with frequent employee turnover and a culture of information sharing. *See id.* at 2–3, 29–57. This culture resulted in knowledge spillovers and new ventures that drove the rapid growth and technological advancement in the region. *Id.* at 161–62. There is some empirical support for Gilson's thesis that California's non-compete policy was critical to the success of Silicon Valley. Garmaise, *supra* note 62, at 410.

Our empirical findings, though they do not allow for definitive conclusions, may indicate that firms in low-noncompetition enforcement jurisdictions are better suited to make investments in R&D. This suggests that the success of Silicon Valley may in part be linked to California's public policy of not enforcing covenants not to compete.

*Id.* See also Bruce C. Fallick et al., *Job-Hopping in Silicon Valley: Some Evidence Concerning the Micro-Foundations of a High Technology Cluster* 20–21 (Inst. for the Study of Lab., FEDS Working Paper No. 2005-11, 2005), <http://ssrn.com/abstract=688446>.

This paper uses new data to compare the inter-firm mobility of college educated male employees in Silicon Valley's computer industry to similarly educated employees working in the computer clusters in other cities. The hyper mobility we document for Silicon Valley's computer cluster is consistent with Saxenian's account of agglomeration economies there: frequent job-hopping facilitates the rapid reallocation of resources towards firms with the best innovations. Our finding of a "California" effect on mobility lends support to Gilson's hypothesis that the unenforceability of [non-compete] agreements under California state law enhances mobility and agglomeration economies in IT clusters.

*Id.*

64. See Norman D. Bishara & David Orozco, *Using the Resource-Based Theory to Determine Covenant Not to Compete Legitimacy*, 87 *IND. L.J.* 979, 1022–30 (2012) (proposing framework based on the resource-based theory of the firm and knowledge-based perspective of competitive advantage). See also Viva R. Moffat, *The Wrong Tool for the Job: The IP Problem with Noncompetition Agreements*, 52 *WM. & MARY L. REV.* 873, 922 (2010) (recommending legislative prohibition of employee non-competes based on IP concerns); Norman D. Bishara, *Covenants Not to Compete in a Knowledge Economy: Balancing Innovation from Employee Mobility Against Legal Protection for Human Capital Investment*, 27 *BERKELEY J. EMP. & LAB. L.* 287, 318–21 (2006) (arguing for stronger enforcement of non-competes against "service" employees than for "creative" employees). We have proposed a framework that allows carefully tailored non-compete agreements designed to protect goodwill, but not trade secrets. Garrison & Wendt, *supra* note 37, at 173–78. Trade secrets would not be considered a protectable interest, but would be protected under the trade secret law, particularly the inevitable disclosure doctrine. *Id.* at 177–86.

65. See Erik Weibust, *Massachusetts Non-Compete Legislative Update*, *LEXOLOGY* (July 24, 2013), <http://www.lexology.com/library/detail.aspx?g=f5443608-1f1e-427d-a704-7da7b75dae66>.

covenants as “void and unenforceable.”<sup>66</sup> Proponents of the law rely on the Silicon Valley success, particularly as it compares to the Massachusetts experience in promoting the IT sector.<sup>67</sup>

*B. The Present State of the Law of Employee Non-compete Agreements*

The present state of employee non-compete law reflects the development of the law over time and the conflicting standards adopted by jurisdictions, with some states adhering to the strict scrutiny of the common law and others adopting the more permissive modern view.<sup>68</sup> Thus, rather than a uniform approach among jurisdictions, current law is a patchwork of divergent judicial and statutory approaches.<sup>69</sup>

On one end of the spectrum, a minority of jurisdictions take an extremely restrictive approach to employee non-compete agreements, typically under statutory controls. California and North Dakota are the most restrictive states, prohibiting almost all employee non-compete agreements under a strict construction of their restraint-of-trade statutes.<sup>70</sup>

On the other end of the spectrum, some jurisdictions have adopted a permissive approach to such agreements.<sup>71</sup> The modern liberalization of state rules on employee non-competes has been achieved through a combination of statutory enactments and judicial modifications of the common law reasonableness test. Florida has the most permissive law, having passed a pro-employer statute in 1996 that in many respects deviates from the common law.<sup>72</sup> Ohio is illustrative of those

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66. S. 169, 189th Gen. Court, Reg. Sess. (Mass. 2015).

67. See Scott Kirsner, *Big Shift: Governor Patrick Now Supports Making Noncompete Agreements Unenforceable in Massachusetts*, BOSTON.COM (Sept. 10, 2013, 1:45 PM), [http://www.boston.com/business/technology/innoeco/2013/09/big\\_shift\\_governor\\_patrick\\_now.html](http://www.boston.com/business/technology/innoeco/2013/09/big_shift_governor_patrick_now.html).

68. See Bishara, *supra* note 51, at 755–59, for the most comprehensive and systematic analysis of the relative enforcement of non-compete agreements across the United States.

69. *Id.*

70. CAL. BUS. & PROF. CODE § 16600 (West 2008). See N.D. CENT. CODE § 9-08-06 (2008). See also *Metro Traffic Control, Inc. v. Shadow Traffic Network*, 27 Cal. Rptr. 2d 573, 577 (Cal. Ct. App. 1994) (“California courts have consistently declared this provision an expression of public policy to ensure that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.”); *Warner & Co. v. Solberg*, 634 N.W.2d 65, 67 (N.D. 2001) (rejecting trade secret exception to § 9-08-06).

71. See S.D. CODIFIED LAWS § 53-9-11 (2004) (stating that “[a]n employee may agree with an employer at the time of employment or at any time during his employment not to engage directly or indirectly in the same business or profession as that of his employer for any period not exceeding two years from the date of termination of the agreement”). See also *Am. Rim & Brake, Inc. v. Zoellner*, 382 N.W.2d 421, 424 (S.D. 1986) (overbroad non-compete agreement permissible under statute without a showing of reasonableness).

72. See FLA. STAT. § 542.335(1) (2013) (“[E]nforcement of contracts that restrict or prohibit

jurisdictions that have moved toward a balancing-of-interests approach that is more protective of employer interests than the common law.<sup>73</sup>

Most jurisdictions continue to adhere to the common law reasonableness approach, although there are significant variations among these states.<sup>74</sup> The states differ in terms of the interests that can be protected under employee non-compete agreements<sup>75</sup> and the permissible scope of such agreements.<sup>76</sup>

The common law standard recognizes two primary “protectable” employer interests: trade secrets and goodwill.<sup>77</sup> To justify a post-employment restraint on competition, employers must demonstrate that a former employee will be engaged in some form of unfair competition, such as the pilfering of trade secrets or the improper diversion of clients or customers.<sup>78</sup> Preventing competition *per se* is not a sufficient legal justification for a non-compete agreement<sup>79</sup> even if the employee’s

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competition during or after the term of restrictive covenants, so long as such contracts are reasonable in time, area, and line of business, is not prohibited.”).

73. The leading “modern” cases in Ohio are *Raimonde v. Van Vlerah*, 325 N.E.2d 544 (Ohio 1975) (adopting reformation and multi-factor balancing test for employee non-competes) and *Rogers v. Runfola & Associates*, 565 N.E.2d 540 (Ohio 1991) (recognizing protectable interest in general training of employees).

74. *See, e.g.*, *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 539–40 (Wyo. 1993). *See also* Bishara, *supra* note 51, at 780 (describing most jurisdictions as following “moderate” enforcement of non-compete agreements).

75. *Compare* *Club Aluminum Co. v. Young*, 160 N.E. 804, 806 (Mass. 1928) (no legitimate interest in preventing employee from using experience and instruction gained in employment) *with* *Rogers*, 565 N.E.2d at 544 (recognizing legitimate interest in training provided to employees).

76. *Compare* *Perry v. Moran*, 748 P.2d 224, 229 (Wash. 1987) (en banc), *modified*, 766 P.2d 1096 (Wash. 1989) (en banc) (permitting non-compete that prevented former employee from servicing any client of former employer) *with* *Mertz v. Pharmacists Mut. Ins. Co.*, 625 N.W.2d 197, 204–06 (Neb. 2001) (invalidating as overbroad a non-compete agreement that prohibited a former employee from soliciting customers with whom the employee had no contact in his prior employment).

77. *E.g.*, *Healthcare Servs. of the Ozarks, Inc. v. Copeland*, 198 S.W.3d 604, 610 & n.6 (Mo. 2006) (recognizing that Missouri courts follow the “modern rule”). *See also* MO. REV. STAT. § 431.202 (2010) (stating that a “reasonable covenant in writing promising not to solicit, recruit, hire or otherwise interfere with the employment of one or more employees shall be enforceable” if seeking to protect “[c]onfidential or trade secret business information” or “[c]ustomer or supplier relationships, goodwill or loyalty”).

78. *Whitmyer Bros. v. Doyle*, 274 A.2d 577, 581 (N.J. 1971).

79. Lord Atkinson stated the common law rule as follows:

[The employer] is undoubtedly entitled to have his interest in his trade secrets protected, such as secret processes of manufacture which may be of vast value. And that protection may be secured by restraining the employee from divulging these secrets or putting them to his own use. He is also entitled not to have his old customers by solicitation or such other means enticed away from him. But freedom from all competition *per se* apart from both these things, however lucrative it might be to him, he is not to be protected against. He must be prepared to encounter that even at the hands of a former employee.

*Herbert Morris, Ltd. v. Saxelby*, [1916] 1 A.C. 688, 702.

ability to compete was enhanced by his work experience.<sup>80</sup> Employees cannot be prevented from using the general skills and knowledge acquired through their employment in competition with their former employers because the law recognizes that employees have a right to their intellectual capital.

The scope of an agreement not to compete also must be reasonable considering the employer's business interest. The terms of the restriction cannot be more extensive than necessary to serve that protectable interest.<sup>81</sup> Courts consider the agreement in terms of time and geographic scope<sup>82</sup> as well as the breadth of the restriction on post-employment competitive activities. The impact of the restriction on the employee and the effect on competition in the market are additional factors considered under the common law reasonableness test.<sup>83</sup>

### III. EMPLOYEE NON-COMPETE AGREEMENTS AND CONSIDERATION: ALTERNATIVE APPROACHES TO THE AFTERTHOUGHT AGREEMENT

Overall, the law of employee non-compete agreements continues to reflect the common law disfavor of restrictions on post-employment competition. Despite the permissive approaches taken by some jurisdictions in the modern era, most courts continue to carefully scrutinize the terms of such agreements. Heightened judicial scrutiny of employee non-compete agreements, and the divergent approaches to employee non-compete agreements, are reflected in the case law on the afterthought agreement. How the differing judicial approaches to the consideration issue fit into the current law of employee non-competes is explored in this section of the Article.

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80. See *Young*, 160 N.E. at 806 (“[A]n employer cannot by contract prevent his employee from using the skill and intelligence acquired or increased and improved through experience or through instruction received in the course of the employment.”).

81. The type of activities the employee is prohibited from engaging in under the non-compete agreement must be tied to the legitimate interests the employer is seeking to protect. See, e.g., *Bridgestone/Firestone, Inc. v. Lockhart*, 5 F. Supp. 2d 667, 682–85 (S.D. Ind. 1998) (covenant overbroad because it limited former employee from working for competitor in any capacity and precluded him from selling products that were not directly competitive).

82. See *Standard Register Co. v. Kerrigan*, 119 S.E.2d 533, 539 (S.C. 1961).

[T]he general rule [is] that the territorial restraint in a covenant not to compete will, generally speaking, be considered reasonable if the area covered by the restraint is limited to the territory in which the employee was able, during the term of his employment, to establish contact with his employer's customers.

*Id.*

83. See RESTATEMENT (FIRST) OF CONTRACTS §§ 513–15 (AM. LAW INST. 1932).

A. *The Majority Position on the Afterthought Agreement: Continued Employment as Sufficient Consideration*

A majority of jurisdictions hold that “continued employment [is] sufficient consideration” for a non-compete agreement signed by an existing employee.<sup>84</sup> Courts adopting this position rely on several rationales. Some courts find consideration in the employer’s promise to refrain from firing the employee, particularly where there has been explicit or implicit threat of termination if the employee refuses to sign the agreement.<sup>85</sup> Other courts find consideration based on the employer’s promise of continued employment.<sup>86</sup> Practical considerations have also been cited in support of the majority rule. Several courts have noted that if additional consideration was required for an afterthought agreement, employers would be compelled to fire an employee on day one and then hire the employee back on day two after the employee executes a non-compete covenant.<sup>87</sup> It is argued that there is thus “no substantive difference” between the employer’s initial promise of employment and a later promise of continued employment.<sup>88</sup> To require new consideration in this setting is to glorify form over substance.<sup>89</sup>

Under the majority rule, some courts require employment to continue for a substantial or reasonable period of time after the non-compete is executed.<sup>90</sup> Otherwise, the employer could terminate an employee a minute after the employee signed a non-compete agreement and the employee would have “received nothing in exchange” for his new promise not to compete.<sup>91</sup> This qualification to the majority rule is designed to prevent either a failure of consideration or bad faith on the part of the employer.<sup>92</sup> In terms of what constitutes substantial

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84. Yates, *supra* note 31, at 1130.

85. *E.g.*, Simko, Inc. v. Graymar, Co., 464 A.2d 1104, 1107 (Md. Ct. Spec. App. 1983); Zellner v. Stephen D. Conrad, 589 N.Y.S.2d 903, 907 (N.Y. App. Div. 1992).

86. *E.g.*, Farm Bureau Serv. Co. v. Kohls, 203 N.W.2d 209, 212 (Iowa 1972).

87. McRand, Inc. v. van Beelen, 486 N.E.2d 1306, 1314 (Ill. App. Ct. 1985).

88. Copeco, Inc. v. Caley, 632 N.E.2d 1299, 1301 (Ohio Ct. App. 1992).

89. Zellner, 589 N.Y.S.2d at 907 (“We will not encourage unnecessary legal dramatics.”).

90. McGough v. Nalco Co., 496 F. Supp. 2d 729, 745 (N.D. W. Va. 2007) (“Some courts, however, require the employment to continue for a ‘substantial’ or ‘reasonable’ period after the employee signs the covenant to become valid, or adequate, consideration.”). *See also* Yates, *supra* note 31, at 1130–31 (“Nor will courts deem a promise of employment for as long as the employer wants it a bargained-for consideration. Employment must continue for at least a reasonable time.”).

91. Curtis 1000, Inc. v. Suess, 24 F.3d 941, 946 (7th Cir. 1994).

92. *See id.* *See also* Simko, Inc. v. Graymar, Co., 464 A.2d 1104, 1107 (Md. Ct. Spec. App. 1983) (observing that rather than require new consideration to ensure fairness of bargain, rule requiring substantial continued employment effectively prevents bad faith and failure of consideration if employer terminates employment shortly after agreement is executed).



employment, there is no numerical formula, although the courts generally consider employment for several years to be sufficient.<sup>93</sup> What is substantial also depends on the facts and circumstances surrounding the employment relationship and the reasons for the discharge of the employee.<sup>94</sup>

*B. The Minority View: Requiring Separate or Independent Consideration*

A minority of states require some “separate” or “independent” consideration for an afterthought agreement to be binding.<sup>95</sup> This position is arguably consistent with the common law pre-existing duty rule that modifications of a contract require new consideration to be binding.<sup>96</sup> Thus, the modification of the employment agreement must be supported by some additional consideration—the afterthought agreement being “in the nature of a new contract . . . [requiring] new consideration.”<sup>97</sup> A related argument is that the employer’s promise of continued at-will employment cannot constitute sufficient consideration because it is an illusory promise. “A consideration cannot be constituted out of something that is given and taken in the same breath—of an employment which need not last longer than the ink is dry upon the signature of the employee . . . .”<sup>98</sup>

Courts adopting the minority rule have also done so on public policy grounds. There is a legitimate concern about the voluntariness and fairness of a non-compete agreement entered into after employment has commenced, particularly where the employee was not apprised of the non-compete covenant at the time of hire.<sup>99</sup> After employment has

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93. See *Woodfield Grp., Inc. v. DeLisle*, 693 N.E.2d 464, 469 (Ill. App. Ct. 1998) (citing *Agrimerica, Inc. v. Mathes*, 557 N.E.2d 357, 362 (Ill. App. Ct. 1990) (considering two years substantial), *abrogated on other grounds by Roy v. Coyne*, 630 N.E.2d 1024 (Ill. App. Ct. 1994)). *But see* *Mid-Town Petrol., Inc. v. Gowen*, 611 N.E.2d 1221, 1227 (Ill. App. Ct. 1993) (noting that seven months of “post contract employment was comparatively insubstantial”).

94. *Simko*, 464 A.2d at 1107–08. See also *Grinspec, Inc. v. Lance*, No. A-3313-01T1, 2002 WL 32442790, at \*3 (N.J. Super. Ct. App. Div. 2002) (recounting a situation where the employer considered employee’s performance as a factor for termination).

95. *Yates*, *supra* note 31, at 1132–33.

96. See *infra* notes 255–64 and accompanying text for a discussion of the pre-existing duty rule.

97. *George W. Kistler, Inc. v. O’Brien*, 347 A.2d 311, 316 (Pa. 1975) (citing *James C. Greene Co. v. Kelley*, 134 S.E.2d 166, 167 (N.C. 1964)).

98. *Kadis v. Britt*, 29 S.E.2d 543, 548 (N.C. 1944).

99. See, e.g., *Davies & Davies Agency, Inc. v. Davies*, 298 N.W.2d 127, 130–33 (Minn. 1980) (noting that “[m]ere continuation of employment as consideration could be used to uphold coercive agreements” and refusing to enforce non-compete agreement without independent consideration).

commenced, the employee's ability to bargain has "markedly diminished"—presenting the risk of a coerced agreement or at the very least, an agreement that is not a product of equal bargaining positions.<sup>100</sup>

Whether independent or separate consideration is present depends upon the status of the employee before and after the non-compete agreement, specifically whether the employer is bound to "additional duties or obligations"<sup>101</sup> or whether the employee obtains some "real advantages"<sup>102</sup> from the agreement. Independent consideration can consist of increased salary or compensation, promotion or change of job responsibilities, access to confidential information, or additional training.<sup>103</sup>

Oregon has codified a more restrictive version of the minority rule in terms of independent consideration.<sup>104</sup> The statute requires a bona fide advancement of the employee for an afterthought agreement to be enforceable. A *bona fide advancement* has been interpreted to mean a material change in the employee's "job content and responsibilities" and an improved "status within the company."<sup>105</sup> An increase in compensation or benefits without such a change in the employee's status is not a bona fide advancement under this interpretation of the statute.<sup>106</sup>

In 2007, the Oregon legislature amended its employee non-compete statute to require an employer to inform a prospective employee in writing "that a noncompetition agreement is required as a condition of employment."<sup>107</sup> In 2012, New Hampshire adopted a similar notice provision, which was amended in July 2014.<sup>108</sup> The prior New

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where employee did not have an opportunity to examine restrictive covenant until after quitting his old job and starting employment).

100. PEMCO Corp. v. Rose, 257 S.E.2d 885, 890 (W. Va. 1979).

101. Labriola v. Pollard Grp., 100 P.3d 791, 795 (Wash. 2004) (en banc).

102. Davies, 298 N.W.2d at 131.

103. Labriola, 100 P.3d at 794. See also Hopper v. All Pet Animal Clinic, Inc., 861 P.2d 531, 541 (Wyo. 1993) (recognizing that pay raise may be factored into the determination of independent consideration).

104. See OR. REV. STAT. § 653.295(1) (2011), amended by H.R. 3236, 78th Leg. Assemb., Reg. Sess. (Or. 2015). The statute in relevant part provides as follows: "A noncompetition agreement entered into between an employer and employee is voidable and may not be enforced by a court of this state unless . . . [t]he noncompetition agreement is entered into upon a subsequent bona fide advancement of the employee by the employer . . ." OR. REV. STAT. § 653.295(1)(a)(B).

105. Nike, Inc. v. McCarthy, 379 F.3d 576, 583 (9th Cir. 2004).

106. First Allmerica Fin. Life Ins. Co. v. Sumner, 212 F. Supp. 2d 1235, 1240–41 (D. Or. 2002).

107. OR. REV. STAT. § 653.295(1)(a)(A). See also S. 248, 74th Leg. Assemb., Reg. Sess. (Or. 2007) (amending statute with additional requirements).

108. See N.H. REV. STAT. ANN. § 275:70 (Supp. 2014) (amending N.H. REV. STAT. ANN. § 275:70 (2012)). The prior version of the statute—effective from July 14, 2012 to July 27, 2014—stated:

Hampshire notice provision applied to the initial employment and to a “change in job classification”; however, neither the prior nor the current New Hampshire law imposes an independent consideration requirement on the afterthought agreement as under the Oregon statute.<sup>109</sup>

The pre-employment notice provisions are clearly in response to the practice of employers not disclosing non-compete requirements until after employment has commenced, the so-called *cubewrap contracts*.<sup>110</sup> By requiring transparency in the pre-employment process, these laws are designed to prevent this form of bad faith in the afterthought setting. Other jurisdictions may follow the lead of Oregon and New Hampshire. Recently, legislation to require pre-employment notice of non-compete agreements has been proposed in Connecticut, Illinois, and Michigan with varying degrees of success.<sup>111</sup>

#### IV. RECENT DEVELOPMENTS IN THE JUDICIAL APPROACH TO THE AFTERTHOUGHT AGREEMENT

Since 2001, state supreme courts have issued eight opinions on the issue of consideration for the afterthought agreement, including the *Runzheimer* case discussed in the introduction.<sup>112</sup> The court decisions have split 4-4, revealing the substantial divisions among judicial policy makers on how to address the thorny consideration issue.<sup>113</sup> A critical

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Prior to or concurrent with making an offer of change in job classification or an offer of employment, every employer shall provide a copy of any non-compete or non-piracy agreement that is part of the employment agreement to the employee or potential employee. Any contract that is not in compliance with this section shall be void and unenforceable.

N.H. REV. STAT. ANN. § 275:70 (2012).

109. *See id.*

110. *See* Arnow-Richman, *Delayed Term*, *supra* note 29, at 640–41; James F. Hermon, *Pending Legislation Threatens to Reshape Michigan Law Regarding Noncompete Agreements*, LEXOLOGY (Aug. 6, 2012), <http://www.lexology.com/library/detail.aspx?g=b0d9e5fa-5769-4963-929d-2c6f502690f3>.

111. In Connecticut, the proposed bill, “An Act Concerning Employer Use of Noncompete Agreements,” Public Act No. 13-309, was passed by the legislature, but vetoed by Connecticut’s Governor Dannel P. Malloy on Friday, July 12, 2013. *See* H.B. 6658, 2013 Leg., Jan. 2013 Sess. (Conn. 2013), <https://www.cga.ct.gov/2013/act/pa/2013PA-00309-R00HB-06658-PA.htm>. In Illinois, H.B. 0016, 97th Gen. Assemb., Reg. Sess. (Ill. 2011) died in committee. *See* H.B. 0016, 2013 Leg., 97th Sess. (Ill. 2013), <http://www.ilga.gov/legislation/BillStatus.asp?DocTypeID=HB&DocNum=16&GAID=11&SessionID=84&LegID=54394>. Michigan’s H.B. 4198, 98th Leg., Reg. Sess. (Mich. 2015) is currently in committee. Arkansas opted for the majority rule by statute. S.B. 998, 90th Gen. Assemb., Reg. Sess. (Ark. 2015), or Act 921—signed by Governor Asa Hutchinson on April 1, 2015, and effective on August 6, 2015—provides that continued employment is sufficient consideration for a covenant not to compete.

112. *See infra* Part IV.A–G.

113. *See id.*

analysis of these opinions demonstrates the weaknesses and inadequacies of the majority and minority rules and provides support for our position that a good faith requirement would be a preferable policy approach to resolving the consideration issue.

A. *Poole v. Incentives Unlimited, Inc.*

In *Poole v. Incentives Unlimited, Inc.*,<sup>114</sup> the South Carolina Supreme Court had an opportunity to consider the appropriate resolution of the consideration issue. The case involved Carol Poole, an at-will employee of a travel agency, Incentives Unlimited, who was presented with a non-compete agreement three and a half years after her initial employment.<sup>115</sup> She executed the agreement because she was told that she had to sign it to keep her job.<sup>116</sup> Her position with Incentives Unlimited did not change, however.<sup>117</sup> Poole later left the company and began working for another travel agency in violation of the non-compete agreement.<sup>118</sup> She sued Incentives Unlimited when her former employer refused to transfer certain cruise bookings, and the employer counterclaimed for Poole's violation of the restrictive covenant.<sup>119</sup> Both the trial court and the intermediate appeals court rejected the argument advanced by Incentives Unlimited that the continued employment was sufficient consideration for the non-compete agreement.<sup>120</sup>

The *Poole* court recognized that consideration was an essential element of an enforceable non-compete agreement and that at-will employment can provide the necessary consideration for a non-compete agreement entered into at the inception of the relationship.<sup>121</sup> Whether continued employment is sufficient consideration for a covenant executed "days, months, or even years after the initial employment offer" was considered a more difficult question.<sup>122</sup> It found the minority position persuasive, citing specifically to the North Carolina Supreme Court decision in *Kadis v. Britt*.<sup>123</sup> "[W]e adopt the rule that when a covenant is entered into after the inception of employment, separate

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114. 548 S.E.2d 207 (S.C. 2001).

115. *Id.* at 208.

116. *Id.*

117. *See id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 209.

122. *Id.*

123. *Id.* (citing *Kadis v. Britt*, 29 S.E.2d 543 (N.C. 1944)).

consideration, in addition to continued at-will employment, is necessary in order for the covenant to be enforceable.”<sup>124</sup> Because Poole’s duties and salary were not changed when the non-compete agreement was signed, the agreement was unenforceable.<sup>125</sup>

*Poole* demonstrates the rigidity and formalism of the minority rule. Certainly, Incentives Unlimited had a legitimate interest in protecting its customer relationships from an employee who had been with the travel agency for three and a half years. Under the minority rule, however, the court does not have to consider the legitimate interests of the employer—the effect of which in *Poole* was to allow the former employee to leave the agency and engage in unfair competition by exploiting the customer relationships she developed with her former employer. To the extent that Poole was coerced into signing the non-compete agreement, the opinion may have reached the correct result. But a good faith standard that considers more than just the presence of independent consideration would result in a more flexible and pragmatic approach to the afterthought agreement in cases like *Poole*.

#### B. Lake Land Employment Group of Akron, LLC v. Columber

The Ohio Supreme Court opted for the majority rule in *Lake Land Employment Group of Akron, LLC v. Columber*.<sup>126</sup> Lee Columber worked for Lake Land Employment Group from 1988 until 2001.<sup>127</sup> He signed a non-compete agreement in 1991, but he recalled very little about the circumstances surrounding its execution.<sup>128</sup> He recalled reading and signing the agreement, but he did not know whether he had discussed the agreement with Lake Land nor whether he had been told that his continued employment was contingent upon his signing it.<sup>129</sup> He did not receive any separate consideration for the non-compete agreement.<sup>130</sup>

In a 4-3 decision, the *Columber* majority held that “consideration exists to support a noncompetition agreement when, in exchange for the assent of an at-will employee to a proffered noncompetition agreement, the employer continues an at-will employment relationship that could

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124. *Id.*

125. *Id.*

126. 804 N.E.2d 27 (Ohio 2004).

127. *Id.* at 29.

128. *Id.*

129. *Id.*

130. *Id.*

legally be terminated without cause.”<sup>131</sup> The majority reasoned that an at-will employment relationship is a bilateral contract—the employee promising to work in exchange for the employer’s promise to pay the agreed compensation, both promises made on an at-will basis.<sup>132</sup> As such, either party is free to propose a change to the contract at any time.<sup>133</sup> Therefore, the presentation of a non-compete agreement constitutes a proposal to renegotiate the terms, which if accepted, is supported by consideration because “[t]he employee’s assent to the agreement is given in exchange for forbearance on the part of the employer from terminating the employee.”<sup>134</sup>

The court added a caveat to its opinion, responding to the courts and commentators who have asserted that there must be adequate consideration for an afterthought agreement, such as substantial continued employment.<sup>135</sup> Given the court’s “forbearance” rationale, it naturally rejected any inquiry into the adequacy of the continued employment.<sup>136</sup> The majority believed that its refusal to require adequate consideration did not preclude a challenge to an afterthought non-compete agreement on other grounds.<sup>137</sup> The court was apparently suggesting that a discharge shortly after an employee executes a non-compete agreement could be unconscionable or subject to challenge based on other contract defenses, such as duress or fraud.<sup>138</sup> It seems clear, however, that the court did not adopt the qualification to the majority rule that continued employment must be for a substantial time, although the majority was obviously uncomfortable with the implication from its opinion that an employer was free to terminate an employee immediately after he or she signed a non-compete agreement.

The majority opinion in *Columber* was not necessarily surprising. Ohio had often been considered among the jurisdictions following the majority rule,<sup>139</sup> and it is one of the jurisdictions that adopted a permissive approach to the enforceability of employee non-compete

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131. *Id.* at 32.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.* at 33.

136. *Id.*

137. *Id.*

138. *See id.*

139. *See, e.g., id.* at 31 (citing *Copeco, Inc. v. Caley*, 632 N.E.2d 1299 (Ohio Ct. App. 1992), *appeal dismissed*, 630 N.E.2d 662 (Ohio 1994)). *Copeco, Inc. v. Caley* was the leading case in Ohio adopting the majority rule.

agreements.<sup>140</sup> What was surprising was the close split within the court and the strong dissenting opinions in the case. The dissenters not only challenged the majority's underlying assumptions but also pointed out the negative policy implications of the opinion. The first dissenting justice noted that there was no legal detriment to the employer, nor any legal benefit to the employee, the hallmarks of consideration.<sup>141</sup> She noted that the court's forbearance logic actually proved the contrary proposition because the "employer ha[d] relinquished nothing," retaining the same right to discharge the employee before and after the modification.<sup>142</sup> "[W]hen all is said and done, the only difference in the parties' employment relationship before and after [the modification] is the noncompetition agreement. . . . It is precisely because the same at-will employment relationship continues that there is no consideration."<sup>143</sup> The second dissent was more direct in the criticism of the forbearance rationale—stating that the court's opinion sanctioned duress by the employer, the employer's promise not to terminate being coercion, not consideration.<sup>144</sup>

*Columber* demonstrates the practical utility of the majority approach. Employers benefit from the ability to adjust the terms of an employment contract as the employment relationship develops over time, and thereby protect their interests in trade secrets or goodwill. From an economic reality perspective, the majority approach better captures the nature of the afterthought agreement than the minority rule.

However, the forbearance rationale adopted by the *Columber* court is particularly problematic, as pointed out by the dissent. Rather than insist upon an afterthought agreement that is truly voluntary, this rationale may actually encourage employers to threaten employees with discharge to secure their consent to non-compete covenants. Employers wanting to establish that they have, in fact, given up their right to terminate in exchange for the employee's non-compete agreement (a bargained for exchange) may be tempted to present afterthought agreements on a take-it-or-leave-it basis. The court's suggestion that other defenses might be effective at deterring employer bad faith also seems unpersuasive. None of the traditional contract defenses—fraud, duress, or undue influence—appear to be effective at preventing employer wrongdoing because the law recognizes an almost unfettered right to terminate an at-will

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140. Garrison & Wendt, *supra* note 37, at 123–27.

141. *Columber*, 804 N.E.2d at 34 (Resnick, J., dissenting).

142. *Id.*

143. *Id.*

144. *Id.* at 35 (Pfeifer, J., dissenting).

employee.

Also, in contrast to the minority rule, the majority approach does not consider the interests of the employee in an open and fair negotiating process. It provides no incentive for an employer to negotiate non-compete agreements at the inception of employment, to be transparent in those negotiations, or to temper its bargaining power in the afterthought negotiations. A good faith standard that factors in the broader interests of employees provides a more balanced approach to the competing interests of employers and employees.

### C. *Labriola v. Pollard Group, Inc.*

The Washington Supreme Court addressed the consideration issue in *Labriola v. Pollard Group, Inc.*<sup>145</sup> Anthony Labriola was hired by Pollard Group in 1997 as an at-will salesperson under a written employment contract containing a restrictive covenant.<sup>146</sup> Five years later, he was presented with a new three-year non-compete agreement that was much broader in scope, precluding him from competing or working for a competing firm within seventy-five miles of Pollard Group's location in Tacoma, Washington.<sup>147</sup> Labriola received no additional benefits or separate consideration in exchange for the non-compete covenant.<sup>148</sup> In fact, a few months after he executed the non-compete agreement, Pollard Group altered his compensation package, raising the minimum sales threshold for commissions from \$25,000 to \$60,000.<sup>149</sup> Because the new commission schedule would substantially reduce his income, he looked for another sales position.<sup>150</sup> Once his attempts to leave were discovered, he was fired and a prospective employer was warned by Pollard Group that it intended to enforce Labriola's non-compete agreement.<sup>151</sup> When the prospective employer did not hire Labriola, he commenced a lawsuit seeking a declaratory judgment that the 2002 non-compete agreement was unenforceable.<sup>152</sup>

The *Labriola* court embraced the minority rule, stating that the

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145. 100 P.3d 791 (Wash. 2004) (en banc).

146. *Id.* at 792.

147. *Id.*

148. *See id.*

149. *Id.* at 792–93.

150. *Id.* at 793.

151. *Id.*

152. *Id.*



decision followed “longstanding” jurisprudence in the state.<sup>153</sup> A non-compete agreement entered into after employment has commenced requires independent consideration, “new promises or obligations previously not required of the parties.”<sup>154</sup> Because Labriola received no additional benefits and the employer incurred no additional obligations under the non-compete agreement, the court found that the continued employment did not serve as the independent consideration necessary for the employee’s non-compete promise.<sup>155</sup>

The court rejected the employer’s claim that “instruction served as [the needed] consideration.”<sup>156</sup> Because training was not mentioned in the non-compete agreement, and the employer never intended to provide the employee with additional benefits, any training was not the bargained for consideration.<sup>157</sup> “[The] Employer did not promise instruction as consideration for Employee’s promise not to compete.”<sup>158</sup> Moreover, the employer could not demonstrate that the training received after the non-compete agreement was any different from the training before the agreement, indicating that no new consideration was being provided in the form of instruction.<sup>159</sup>

The *Labriola* court adopted a strict two-fold standard for the independent consideration requirement. First, the employee must receive new benefits or the employer must incur new obligations for independent consideration to be present. To make this determination, the court will examine the employee’s position before and after the non-compete agreement, as it did with regard to the promise of training. If the employee’s status has changed in terms of pay or responsibility, independent consideration is present. But if the employee is receiving the same benefits before and after the non-compete agreement, the independent consideration requirement is not satisfied. Conceivably, even an increase in pay or promotion would not be sufficient if the employee would have received the benefits with or without the non-compete agreement.

Second, the independent consideration must be the consideration bargained for in exchange for the non-compete promise. The nature of any independent consideration should obviously be memorialized in the

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153. *Id.* at 796.

154. *Id.* at 794.

155. *Id.* at 794–95.

156. *Id.* at 795.

157. *Id.*

158. *Id.*

159. *Id.*

agreement itself to avoid the employer's problem in *Labriola* where the agreement did not mention the consideration for the non-compete and specifically did not mention training as the consideration. The court's approach to the minority rule may create difficulties for unsuspecting employers, a trap for the unwary employer who either does not provide separate consideration or does not adequately document the employee's change in status.

*Labriola* illustrates one of the weaknesses of the majority approach and one of the reasons for the continuing appeal of the minority rule. To some extent, the impact of the afterthought agreement is to bind the employee more tightly to the employer. Exiting the employer's business becomes even more difficult because of the *in terrorem* effects of non-compete covenants. The mere existence of the non-compete deters prospective employers from hiring an employee burdened by a restrictive covenant, and as in *Labriola*, the threat to sue a prospective employer if they hire a former employee can be a potent weapon in the employer's arsenal. Without even the necessity of the costs of a non-compete lawsuit, the Pollard Group effectively prevented the employment of *Labriola*, leaving the former employee to sue to protect his rights.

Thus, continued employment may exist for some time in the afterthought cases not because employers are acting in good faith—which is the assumption of the majority rule courts—but because employees believe they have no choice but to stay. A better approach is to consider all aspects of good faith to ensure that afterthought agreements are truly voluntary and do not unnecessarily restrict employees' freedom of mobility.

#### D. *Summits 7, Inc. v. Kelly*

The Vermont Supreme Court's 2005 decision in *Summits 7, Inc. v. Kelly*<sup>160</sup> adopting the majority rule was not entirely unexpected, as the state had embraced a permissive approach to employee non-compete agreements.<sup>161</sup> The case involved a young woman, Staci Lasker, who was hired in 2000 by *Summits 7*, a printing and copying company.<sup>162</sup> She started in customer service and later became a sales assistant,

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160. 886 A.2d 365 (Vt. 2005). In this case, "Defendant's maiden name is Staci Kelly, but by the time of trial she was using her married name, Staci Lasker." *Id.* at 367 n.\*.

161. *See, e.g.*, *Vt. Elec. Supply Co. v. Andrus*, 315 A.2d 456, 458 (Vt. 1974) (using a balancing test with burden on employee to establish unreasonableness of covenant to uphold a five-year covenant).

162. *Summits 7*, 886 A.2d at 367–68.

salesperson, and eventually a supervisor before she left the company in 2003.<sup>163</sup> One year after she was hired, Summits 7 required her to sign a non-compete agreement, and she was later required to sign a second agreement in 2002 after Summits 7 acquired another company and took on additional services.<sup>164</sup> The afterthought agreements were without independent consideration and prohibited her from working for any direct or indirect competitor in Vermont, New Hampshire, and parts of New York.<sup>165</sup> She voluntarily left Summits 7 in 2003 and went to work for a direct competitor in a nearby locale.<sup>166</sup>

In holding that continued employment, standing alone, was sufficient to support a non-compete agreement entered into after the commencement of an at-will employment relationship, the majority of the court reasoned that there is no practical or substantive difference between a non-compete promise made at the inception of an employment relationship and one made during the course of that relationship.<sup>167</sup> The consideration in either case, the court observed, is the “initial or continued employment,” or alternatively the employer’s “forbearance from terminating the at-will employment relationship.”<sup>168</sup> The court concluded: “Regardless of what point during the employment relationship the parties agree to a covenant not to compete, legitimate consideration for the covenant exists as long as the employer does not act in bad faith by terminating the employee shortly after the employee signs the covenant.”<sup>169</sup>

As in *Columber*, the majority opinion prompted a strong dissent. The dissent observed that there was no consideration from a legal benefit or legal detriment perspective. “Because Summits 7 relinquished nothing, and Lasker gained nothing, any consideration was illusory.”<sup>170</sup> The dissent also noted that the public policy concerns underlying the judicial scrutiny of non-compete agreements were ignored by the majority—particularly the employer’s abuse of its superior bargaining position to coerce a non-compete promise. “By finding consideration under these circumstances, the majority has eviscerated the public policy concerns requiring consideration for—and close scrutiny of—covenants

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163. *Id.* at 368.

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.* at 372–73.

168. *Id.* at 373.

169. *Id.* (citing *Zellner v. Conrad*, 589 N.Y.S.2d 903, 907 (N.Y. App. Div. 1992)).

170. *Id.* at 375 (Johnson, J., dissenting).

not to compete in employment relationships.”<sup>171</sup>

The *Summits 7* court avoided the facts in the case that pointed to bad faith on the part of the employer. The non-compete the employer required Lasker to sign was problematic for two reasons. First, it was unclear whether or not the employer had any protectable interest to support the agreement not to compete. Lasker was with the company for three years, starting as a low-level employee and eventually becoming a “supervisor.” She was involved in sales as an assistant and then as a salesperson, but there is no indication that she had established the type of personal relationships with customers that could be exploited. The trial court held that “Lasker’s general development as an employee—her learning how to handle increased responsibilities concerning the business—was adequate consideration” for the non-compete,<sup>172</sup> but this type of general knowledge, skills, and experience is not generally sufficient to justify a restrictive covenant.

Second, the non-compete Lasker signed was facially overbroad even if the company had a protectable interest in its customer relationships. The agreement extended to all of Vermont, New Hampshire, and parts of New York. It also precluded her from working “in any capacity” for a direct or “indirect” competitor of *Summits 7*. The unreasonableness of the covenant should have called into question the actual purpose of the agreement. Was it to protect the business interests of the employer? If so, why was the restriction not tied to those interests, directed at precluding competitive activities or soliciting former customers? Or was it designed to simply prevent her from working in the industry—that is, using her experience with another employer in the trade? The trial court suggested as much in its determination of consideration. The *Summits 7* court addressed only the geographic scope of the agreement, refused to consider the overbreadth problem, and concluded that the non-compete agreement should be enforced because the former employee went to work for a local direct competitor.

The *Summits 7* court also did not address the pressure used to secure Lasker’s consent to the non-compete covenants. As the dissent noted, a person of her limited means and education had little choice but to consent to the demand that she sign the non-compete agreements. *Summits 7* demonstrates the inadequacy of the majority approach that focuses solely on continued employment of the employee. It suggests that a focus on both the substantive problems with the non-compete

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171. *Id.*

172. *Id.* at 377.

agreement and the issues relating to the negotiation process under a broader good faith standard would be a preferable approach.

*E. Access Organics, Inc. v. Hernandez*

Another recent afterthought opinion is the 2008 decision of the Montana Supreme Court in *Access Organics, Inc. v. Hernandez*.<sup>173</sup> Andy Hernandez was hired by Access Organics to sell organic produce and later promoted to sales manager.<sup>174</sup> Four months after he was hired and a month after his promotion, he signed a non-compete agreement that prevented him from “directly or indirectly compet[ing]” with Access Organics for two years.<sup>175</sup> Having financial difficulties, Access Organics laid him off shortly after he signed the agreement.<sup>176</sup> Hernandez returned to the company on a part-time basis, but shortly thereafter, however, he voluntarily left Access Organics and started his own business with another former employee selling both organic and conventional produce in competition with Access Organics.<sup>177</sup> The district court found that Hernandez contacted customers he knew before he joined Access Organics as well as contacts he gained during his short time with his former employer.<sup>178</sup> The trial court found the necessary consideration for the agreement in the continuation of his employment and enjoined Hernandez “from contacting any current or former client of Access Organics” in the sale of organic produce.<sup>179</sup>

The *Access Organics* court relied heavily on the strong state public policy disfavoring non-compete agreements under the state’s restraint-of-trade statute, a law designed to protect a person’s right to freely engage in a chosen occupation or profession.<sup>180</sup> The court essentially adopted the minority position on the consideration issue. In the absence of independent consideration, “additional job security,” or a promise of a definite extended term of employment, the continued employment of an at-will employee does not serve as sufficient consideration for an afterthought agreement.<sup>181</sup>

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173. 175 P.3d 899 (Mont. 2008).

174. *Id.* at 901.

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.* at 901–02.

180. *Id.* at 902–03 (citing *Dumont v. Tucker*, 822 P.2d 96, 98 (Mont. 1991)).

181. *Id.* at 904.

The court recognized the potential for employer unfair bargaining to secure an afterthought agreement, and this risk of overreaching justified a probing judicial examination of the afterthought agreement. But the court, by adopting the minority rule, did not examine whether in fact there was bad faith in the bargaining process. In terms of bad faith, the record is somewhat conflicting. The timing of the presentment of the non-compete in *Access Organics* can be viewed as suggestive of bad faith. The non-compete was neither presented at the beginning of the employment relationship nor was it part of the promotion. But it is not clear whether there was any pressure on Hernandez to sign the non-compete agreement, and Access Organics certainly had a legitimate interest in protecting its customer relationships. The overbreadth of the afterthought agreement is more troubling particularly when it is combined with the delay in presenting the agreement. At two years, the agreement was relatively long and the scope was quite broad—preventing both direct and indirect competitive activities and arguably including the sale of conventional produce. Hernandez may not have been willing to enter into such an overbroad agreement had he been presented with it at the time of hire.

F. *Lucht's Concrete Pumping, Inc. v. Horner*

The Colorado Supreme Court adopted the majority rule in *Lucht's Concrete Pumping, Inc. v. Horner*.<sup>182</sup> Tracy Horner was hired by Lucht's Concrete Pumping, a commercial and residential concrete contractor primarily doing business in Denver, as the “key person” to lead its business expansion into Summit County, Colorado.<sup>183</sup> Horner was responsible for developing and maintaining customer relationships in that area.<sup>184</sup> Two years after he was hired, he was requested to and did sign a non-solicitation and confidentiality agreement.<sup>185</sup> Horner was not offered any form of pay increase, promotion, or any kind of additional benefits when he signed this agreement.<sup>186</sup> One year later, Horner left the company and went to work for Everist Materials, a supplier of ready-mix concrete, with many of the same customers in the mountain region as his former employer.<sup>187</sup> Shortly thereafter, Everist Materials entered

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182. 255 P.3d 1058 (Colo. 2011) (en banc).

183. *Id.* at 1060.

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.*

the concrete pumping business with Horner as its pumping manager—in apparent violation of the one-year non-solicitation agreement.<sup>188</sup> In Lucht’s Concrete Pumping’s suit against Horner, the trial court granted summary judgment against Lucht’s and concluded that the non-compete agreement was “unenforceable due to lack of consideration,” and the court of appeals affirmed, adopting the minority rule.<sup>189</sup>

Despite the strong public policy against non-compete agreements in Colorado,<sup>190</sup> the Colorado Supreme Court reversed this holding.<sup>191</sup> The court noted the long-standing rule that a covenant not to compete as any other contract must be supported by consideration, and “some consideration, regardless of its relative value” is all that is necessary to support a non-compete agreement.<sup>192</sup> Noting that the giving up of a legal right can constitute such consideration, the court held that the employer’s forbearance from terminating an employee constitutes the necessary consideration for the agreement with the existing at-will employee.<sup>193</sup>

The *Lucht’s Concrete* court found no distinction between consideration at the inception or during the course of employment.<sup>194</sup> At both stages, the parties are free to negotiate the employment terms and employees are free to accept or reject modified conditions, just as they are free to accept or reject the initial offer.<sup>195</sup> The court also observed that to require employers to terminate and then rehire employees to secure the benefit of a non-compete covenant “would create a perverse incentive for employers”<sup>196</sup> in the at-will employment setting.

The court did not address the inherent problem with mid-stream changes in the employment-at-will context and the practical leverage the employer has in this setting. Had it considered that element and conducted a good faith analysis of the afterthought agreement, the court may have concluded that there was no bad faith. From a substantive perspective, Lucht’s Concrete Pumping appeared to have a legitimate protectable interest in its customers, and the non-solicitation agreement

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188. *Id.*

189. *Id.*

190. See COLO. REV. STAT. § 8-2-113(2)(d) (2013) (showing that under Colorado’s restrictive statute, only non-compete agreements of high-level employees are generally enforceable). Colorado courts have narrowly construed the statute because of the strong public policy disfavoring such agreements. *Gold Messenger, Inc. v. McGuay*, 937 P.2d 907, 910 (Colo. App. 1997).

191. *Lucht’s Concrete*, 255 P.3d at 1061.

192. *Id.*

193. *Id.*

194. *Id.* at 1062–63.

195. *Id.* at 1062.

196. *Id.* at 1063 (citing *Summits 7, Inc. v. Kelly*, 886 A.2d 365, 372–73 (Vt. 2005)).

was a limited restraint tied to that goodwill interest. Moreover, there was no apparent evidence of coercion by the company in securing Horner's consent to the agreement, nor was there any indication that the timing of the company's request was a bad faith negotiating tactic.

The court was concerned, however, with the logical implications of its forbearance rationale. Because the value of consideration is not important, and the employer's consideration is giving up the right to terminate at the time of the non-compete agreement, an employer could secure a non-compete on the first day of hire and terminate the employee on next day.<sup>197</sup> Nevertheless, the court suggested that such conduct would be a factor in the overall reasonableness analysis of the non-compete agreement,<sup>198</sup> but it failed to identify how factors bearing on consideration play into that assessment, a determination that generally focuses on the necessity for and substantive terms of a particular restrictive covenant.

*Lucht's Concrete* follows the majority rule in not requiring separate consideration to enforce a non-compete agreement, with the qualification that the agreement, including the consideration to support it, meets the reasonableness standard for non-compete agreements. It is unclear, however, whether the court's reasonableness qualification will temper the potential abuse by employers of their superior bargaining positions. By "folding" consideration into the reasonableness analysis, the court adds another dimension to the array of majority rule opinions struggling to deal with the implications of the underlying forbearance rationale.

#### G. *Charles T. Creech, Inc. v. Brown*

One of the most recent afterthought opinions is the 2014 decision of the Supreme Court of Kentucky in *Charles T. Creech, Inc. v. Brown*.<sup>199</sup> The *Creech* court adopted the position that continued employment, standing alone, is insufficient to support an afterthought agreement.<sup>200</sup> In doing so, the court distinguished several prior Kentucky cases that had enforced non-compete agreements signed after employment had commenced.<sup>201</sup> The *Creech* court's analysis of those precedents, however, muddies the clarity of the new rule it announced.

The case facts were relatively simple and straightforward. Donnie

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197. *Id.*

198. *Id.*

199. 433 S.W.3d 345 (Ky. 2014).

200. *Id.* at 353–54.

201. *Id.* at 354.



Brown had worked eighteen years for Charles T. Creech, Inc., advancing to a sales position in this business that provides hay and straw to farms in Kentucky.<sup>202</sup> Two years prior to his departure, he signed a “Conflicts of Interests” agreement that included a three-year non-compete covenant.<sup>203</sup> In an apparent violation of the contract, Brown went to work for Standlee Hay Company—a competitor—and solicited customers he had serviced at Creech.<sup>204</sup> The ensuing lawsuit eventually reached the Supreme Court of Kentucky after the Court of Appeals reversed the trial court’s summary judgment for Standlee and Brown, concluding that “Brown’s continued employment with Creech constituted sufficient consideration” as a matter of law.<sup>205</sup>

Prior case law in Kentucky appeared to support the Court of Appeals’ decision. In *Higdon Food Service, Inc. v. Walker*,<sup>206</sup> the Supreme Court of Kentucky found the employee’s continued employment and a good faith standard for termination in an afterthought agreement sufficient to render a non-compete covenant enforceable.<sup>207</sup> The *Higdon* court reasoned that there was consideration in two respects. First, the “hiring itself (or rehiring, if one prefers that word) was sufficient consideration” because the company “did not have to hire [the employee]—or keep him on—at all.”<sup>208</sup> Second, the employment contract could be terminated only for a “good faith” determination that the employee’s services were “no longer satisfactory” or “no longer needed.”<sup>209</sup> Thus, the employee had acquired some new consideration under the employment contract.<sup>210</sup>

The *Creech* court also had to finesse *Central Adjustment Bureau v. Ingram Associates, Inc.*,<sup>211</sup> an opinion in which the Kentucky Court of Appeals had adopted a variant of the majority rule. The court concluded that as long as employment continues for an “appreciable length of time”<sup>212</sup> and the employee is not involuntarily terminated, an afterthought agreement is enforceable.<sup>213</sup> The court reasoned that under such

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202. *Id.* at 347.

203. *Id.*

204. *Id.* at 348.

205. *Id.* at 350–51.

206. 641 S.W.2d 750 (Ky. 1982).

207. *See id.* at 751–52.

208. *Id.* at 751.

209. *Id.* at 752.

210. *Id.*

211. 622 S.W.2d 681 (Ky. Ct. App. 1981).

212. *Id.* at 685.

213. *See id.*

circumstances “the employer has fulfilled an implied promise to continue the employee’s employment . . . .”<sup>214</sup>

The *Creech* court ignored the Court of Appeals holding in *Central Adjustment Bureau* and proceeded to distinguish the case.<sup>215</sup> Significantly, Donnie Brown was a long-term employee at Creech, whereas the employees in *Central Adjustment Bureau* signed the non-competes within weeks or months after the commencement of employment.<sup>216</sup> The employees in *Central Adjustment Bureau* also received specialized training, raises, and promotions after signing the non-compete agreements, but Brown did not.<sup>217</sup>

By narrowly reading *Higdon* and distinguishing *Central Adjustment Bureau*, the *Creech* court manages to identify the “common thread” in the cases; that is, the “employment relationship between the parties changed” after the non-compete was signed.<sup>218</sup> The *Creech* court recognized that, in *Higdon*, it was the change in status from an at-will employee to a more protected employee under the “good faith” discharge limitation.<sup>219</sup> In *Central Adjustment Bureau*, it was the change in employment terms, specifically the training, promotions and compensation increases.<sup>220</sup> In contrast, “Brown received no consideration from Creech in exchange for signing the Agreement or after he signed the Agreement.”<sup>221</sup>

As a result, the *Creech* court adopts a modified version of the minority rule. Continued employment, standing alone, is not sufficient for an afterthought agreement. Consideration will exist, however, if there is independent consideration at the time of the execution of the non-compete *or provided after the covenant is signed*. Unlike the minority rule adopted in *Labriola* and other minority rule jurisdictions,<sup>222</sup> the independent consideration does not have to be part of a bargained-for exchange.

Also, it is unclear under *Creech* whether this new rule on continued employment applies to the *cubewrap contract* cases in which non-competes are signed shortly after employment has commenced. Given

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214. *Id.*

215. *See* Charles T. Creech, Inc. v. Brown, 433 S.W.3d 345, 354 (Ky. 2014).

216. *Id.*

217. *Id.*

218. *Id.*

219. *See id.*

220. *Id.*

221. *Id.*

222. *See supra* Part IV.C.

the court's discussion of *Central Adjustment Bureau*, it would appear that such cases would be treated differently. Perhaps this different treatment is based on the rationale that the non-compete is contemporaneous with the initial employment, or this scenario is a technical "hiring" under the language of *Higdon*.

Finally, the impact of a threat to discharge is uncertain under *Creech*. The lack of any threat to discharge was one of the facts the court cited in distinguishing *Central Adjustment Bureau*: "Creech, unlike Central, did not threaten Brown with loss of his job if he did not sign the Agreement."<sup>223</sup> An employer giving up the right to terminate "at-will" could be viewed as providing the necessary consideration or this could constitute a "rehire" under *Higdon*.<sup>224</sup> But, of course, giving up the immediate right to terminate is just the other side of the continued employment coin, which the *Creech* court finds insufficient. Nevertheless, under this reading of *Creech*, employers may be encouraged to threaten discharge to establish consideration in the afterthought context.

The court had some evidence of bad faith in *Creech*, which may have been one of the underlying equitable reasons for its decision. Shortly after securing the non-compete agreement, Creech demoted Brown from his job as a salesperson to a dispatcher.<sup>225</sup> In that sense, the case is similar to *Labriola*, where the employer altered the employee's compensation package after a new, more restrictive non-compete covenant was signed.<sup>226</sup> But the *Creech* court does not explicitly rely on the employer's bad faith conduct in tying its holding to whether continued employment is sufficient consideration for an afterthought agreement. Arguments made in an amicus filing by labor groups, which urged the court to consider the policy issues underlying employee non-compete agreements, were rejected.<sup>227</sup> What emerges from *Creech* is a lack of clarity on the application of the minority rule in Kentucky and, yet, another opinion that fails to provide a coherent, policy-based approach to the consideration issue.

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223. *Creech*, 433 S.W.3d at 354.

224. *See Higdon Food Serv., Inc. v. Walker*, 641 S.W.2d 750, 752 (Ky. 1982) (stating that the employment agreement signed by Walker ostensibly included a good faith provision where the employment "shall continue only as long as the services rendered by the Employee are satisfactory to the Employer, regardless of any other provision contained in [the] agreement").

225. *See Creech*, 433 S.W.3d at 347-48 ("This job change did not involve any change in salary but did result in Brown having decreased responsibilities and little to no direct customer contact.").

226. *See supra* notes 146-49 and accompanying text.

227. *See Creech*, 433 S.W.3d at 351-52.

### *H. Summary*

The recent afterthought opinions reflect a continuing split among the courts regarding the consideration issue. The weaknesses of both the minority and majority approaches are evident from a reading of these decisions, pointing to the need for an alternative approach based on more than a simple, myopic focus on either independent consideration or continued employment.

## V. CONSIDERATION FOR THE AFTERTHOUGHT AGREEMENT: A CRITICAL POLICY ANALYSIS OF THE COMPETING APPROACHES

### *A. The Futility of a Contract-Based Analysis of the “Afterthought” Agreement*

As in *Creech*, courts addressing the consideration issue in the afterthought context have struggled to apply traditional contract law rules to the employment relationship. From a doctrinal standpoint, reasonable arguments can be made in support of the minority and majority rules, as noted by the most recent afterthought opinions and dissents. And even though pages and pages of court opinions and law articles have been devoted to the issue, traditional contract law rules relating to consideration will not provide a proper resolution of the consideration issue in the afterthought context.

Either rule can be justified or critiqued based on an application of contract law. By requiring independent consideration, the minority approach follows the traditional pre-existing duty rule of contract law. Modification of a contract generally requires new or additional consideration to be binding—something more than the initial consideration provided by a party. A promise to do what one is already required to do is not sufficient for a modification. Thus, it can be persuasively argued that an employer’s promise of indefinite employment is nothing more than what has already been promised an existing employee. Courts adopting the majority rule have to engage in strained reasoning to find consideration on the part of an employer who suffers no legal detriment in exchange for the employee’s promise not to compete.

On the other hand, courts adopting the minority rule and finding consideration for a non-compete at the inception of the employment relationship but not during the course of that relationship are faced with an inherent inconsistency. In either situation, the employee’s promise not to compete is supported only by the employer’s promise of indefinite

employment. If one is analyzing the issue from a strictly contract doctrine perspective, it is unclear why the law should recognize the employer's promise of indefinite employment as consideration at the beginning but not during the relationship. The employment-at-will doctrine presents a similar problem of logical consistency. It does not necessarily make sense to say that an employer can terminate a contract of employment-at-will but does not have the right to change the terms of the contract at-will.

The root problem is the employment-at-will doctrine. At-will employment is at its core a legal fiction—a “contract” that is based on what otherwise would be characterized as illusory promises.<sup>228</sup> As one commentator noted, the “at-will relationship is not the result of a true contract,” and therefore traditional common law principles are “ill-suited to the task” of resolving issues of consideration under the at-will employment relationship.<sup>229</sup> This commentator has also posited that courts have manipulated contract law principles to achieve desired results.<sup>230</sup>

At least one court has rejected the majority and minority approaches as being “misguided.”<sup>231</sup> In *McGough v. Nalco Co.*, the court found that decisions on the afterthought agreement were actually not based on consideration: “By resting decisions solely on consideration grounds, courts actually disguise the true reasons for their decisions, which instead are grounded in equitable doctrines of fairness.”<sup>232</sup> The court followed Alabama common law, where continued employment was sufficient consideration for an afterthought agreement, but it considered other “fairness” dimensions in equity in determining whether to grant an injunction.<sup>233</sup>

The *McGough* court was not persuaded by the rationale or logic of the majority rule. Because an employer gives up nothing to secure the employee's non-compete promise in the afterthought setting, there is no “corresponding restriction” on the employer's power to discharge and the promise is illusory.<sup>234</sup> Moreover, the requirement of “substantial”

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228. Richard A. Lord, *The At-Will Relationship in the 21st Century: A Consideration of Consideration*, 58 BAYLOR L. REV. 707, 773–74 (2006).

229. *Id.* at 774.

230. *See id.* at 749–50 (“[C]ourts . . . are ignoring both the requirement that the consideration be bargained for and that . . . ‘in practice it is performance which is bargained for.’”) (citations omitted).

231. *McGough v. Nalco Co.*, 496 F. Supp. 2d 729, 747 (N.D. W. Va. 2007).

232. *Id.* (citing Yates, *supra* note 31, at 1127).

233. *Id.* at 741–43.

234. *Id.* at 747.

continued employment is inconsistent with fundamental contract law principles: having to look back to the time when the contract is formed at some uncertain point in the future breeds unpredictability.<sup>235</sup>

The court was equally critical of the minority approach. By assessing whether “benefits promised or conferred . . . are substantial enough to warrant an exchange for a signed covenant,” courts are in effect judging the adequacy of consideration contrary to basic contract law.<sup>236</sup> And because this judgment about the adequacy of consideration is subjective and after the fact, the “approach also breeds uncertainty.”<sup>237</sup>

The *McGough* court’s critique of the majority and minority approaches reflects the unsound premises underlying those rules. To develop a legal framework for resolving the competing interests in the afterthought context on traditional conceptions of legal detriment and legal benefit is inherently flawed and results in the problems associated with either approach identified by the court. Rather than build a framework on such flawed premises, we contend that an approach to the afterthought agreement based on an analysis of the policies underlying contract law, the employment-at-will doctrine, and employee non-compete law is both necessary and desirable.

Stated simply, such an approach needs to consider the competing employer, employee, and societal interests in the afterthought context. How do we allow employers the flexibility to adjust and adapt the terms of the employment relationship to protect business assets and also protect employees from unfair bargaining tactics in the afterthought context? And how do we do that under a framework that is consistent with contract law but sensitive to the societal interests in free and fair competition by former employees? A critical analysis of the majority and minority courts’ approaches provides insight on an alternative approach to the afterthought agreement.

### *B. A Policy Analysis of the Minority Rule*

The minority rule, which requires separate consideration for an afterthought agreement, is defensible from a public policy perspective. The policies underlying the pre-existing duty rule are implicated by the afterthought agreement. That rule is designed in part to prevent the old *hold-up game*, as with the contractor who “extorts” a promise of

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235. *Id.* at 747–48.

236. *Id.* at 748.

237. *Id.* (citing Tracy L. Staidl, *The Enforceability of Noncompetition Agreements When Employment Is At-Will: Reformulating the Analysis*, 2 EMP. RTS. & EMP. POL’Y J. 95, 108 (1998)).

additional consideration out of the property owner by threatening to walk off the job.<sup>238</sup>

Arguably, this underlying policy rationale supporting the pre-existing duty rule applies to the afterthought agreement. In fact, the bargaining power wielded by an employer may present an even stronger argument for additional consideration than the traditional *hold-up game* scenario. The employer may gain an unfair advantage after employment has commenced and be able to use its superior bargaining position to secure an agreement during the course of employment that it might not have been able to secure during the initial negotiations.

The employer's leverage in "negotiating" the afterthought agreement is substantially enhanced by the employment-at-will doctrine and the lack of any remedy for an employee discharged for refusing to sign a non-compete agreement. Outside of California, the courts have uniformly held that an employee fired for refusing to sign a non-compete agreement has no claim for wrongful discharge under the public policy exception to the at-will doctrine, even if the agreement is patently unreasonable.<sup>239</sup>

An illustrative example of the bargaining power of employers in this context was presented in *Maw v. Advanced Clinical Communications, Inc.*<sup>240</sup> Karol Maw was employed as a graphic designer for four years by Advanced Clinical Communications, Inc. (ACCI), a firm providing educational programs in the pharmaceutical and healthcare industries.<sup>241</sup> In 2001, the company decided that all employees at the level of "Coordinator" would be required to sign an employment contract with non-disclosure and non-compete provisions.<sup>242</sup> The non-compete clause precluded an employee for a period of two years after termination from working for a competitor of ACCI or one of ACCI's customers.<sup>243</sup>

The non-compete agreement was problematic for multiple reasons. It did not serve any legitimate interest of ACCI because Maw had no

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238. See *infra* notes 259–60 and accompanying text for a discussion of the *hold-up game*.

239. See Michael J. Garrison & Charles D. Stevens, *Sign This Agreement Not to Compete or You're Fired! Noncompete Agreements and the Public Policy Exception to Employment at Will*, 15 EMP. RESPS. & RTS. J. 103 (2003).

240. 846 A.2d 604 (N.J. 2004). See generally Michael J. Garrison, *Limiting the Protection for Employees from Compelled Noncompete Agreements Under State Whistleblower Laws: A Critical Analysis of Maw v. Advanced Clinical Communications*, 20 LAB. LAW. 257 (2005) (discussing the *Maw* decision).

241. *Maw v. Advanced Clinical Commc'ns, Inc.*, 820 A.2d 105, 109 (N.J. Super. Ct. App. Div. 2003), *rev'd*, 846 A.2d 604 (N.J. 2004).

242. *Id.* at 110.

243. *Id.*

knowledge of protected trade secrets in her position.<sup>244</sup> She had little if any knowledge of the content and technical aspects of the materials she helped produce and had no greater access to proprietary information than clerical employees, who were not required to sign the employment contracts.<sup>245</sup> The non-compete was also patently unreasonable in terms of scope and time. For two years, Maw was prohibited from working in any capacity for an ACCI competitor or customer.<sup>246</sup>

Finally, ACCI did not act in good faith in the negotiation process. ACCI urged employees to secure “independent counsel” to review the terms of the afterthought agreement.<sup>247</sup> After consulting an attorney, Maw attempted to negotiate changes to the agreement, specifically a shorter non-compete period, but she was informed that ACCI’s President would not permit any modifications to the agreement.<sup>248</sup> When she refused to sign the agreement, she was fired.<sup>249</sup>

Maw sued ACCI under New Jersey’s public policy exception to employment-at-will and the state’s whistleblower statute, the Conscientious Employee Protection Act (CEPA).<sup>250</sup> Despite long-standing judicial disfavor of non-compete agreements in New Jersey, the court found no clear mandate of public policy implicated in the firing.<sup>251</sup> The court was concerned with “alter[ing] the traditional contract remedies available in restrictive-covenant litigation.”<sup>252</sup> Thus, even if a non-compete agreement is on its face unreasonable, which appeared to be the case in *Maw*, an employee refusing to sign it has no legal remedy for this form of employer overreaching.

*Maw* and the majority of courts that have addressed the wrongful discharge issue place employees presented with an afterthought agreement in an extremely vulnerable position. In effect, employers can present broad, standardized non-compete agreements on a “take-it-or-leave-it” basis and hold the threat of discharge over their employees’ heads to compel an “agreement.” Employees can sign such agreements, but they then risk the cost and expense of defending lawsuits brought to enforce the non-compete covenants and the potential impact on

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244. *Id.* at 114–15.

245. *Id.* at 111, 114.

246. *Id.* at 109.

247. *Id.* at 111.

248. *Id.*

249. *Id.*

250. See N.J. STAT. ANN. §§ 34:19-1 to -8 (2011); *Maw v. Advanced Clinical Commc’ns, Inc.*, 846 A.2d 604, 606–07 (N.J. 2004).

251. *Maw*, 846 A.2d at 609.

252. *Id.*



prospective employers who may be concerned with a lawsuit for intentional interference with a contract if they hire an employee “bound” by a restrictive covenant.

By requiring “independent” or “separate” consideration, the courts temper that bargaining power, and protect employees to some extent from the economic leverage that employers possess in the afterthought context. The minority rule also provides an incentive for employers to secure promises at the start of the employment relationship because, without separate consideration, an afterthought agreement is not enforceable.

Like any prophylactic rule, however, the minority approach is over-inclusive. It protects employees from employer overreaching in some cases, but it may result in unfair competition by employees in others. Had the *Lucht’s Concrete* court invalidated what appeared to be a voluntary and limited non-solicitation agreement because of a lack of independent consideration, the employee could have directly competed with his former employer by exploiting his relationships with the former employer’s customers.

### C. A Policy Analysis of the Majority Rule

Despite the arguments for the minority rule, the majority position has considerable merit from a policy perspective. It can be persuasively argued that the law should reflect the economic realities of the employment relationship rather than follow a formalistic approach to the consideration question. The *Columber* court’s pragmatic approach comes close to capturing the practical reality of the modern employment relationship. The court’s characterization of the employment relationship as a continually evolving one, where terms are constantly being changed, has appeal. Thus, viewing the presentation of a non-compete agreement to an existing at-will employee as a proposal to alter the terms that is accepted by continued employment seems to reflect the economic reality of the situation.

However, courts adopting the majority approach have struggled to find a limiting principle for the continued employment rule. Taken to an extreme, the underlying forbearance rationale is problematic. As the dissent in *Columber* suggested, this rationale may actually encourage employers to threaten employees with discharge or engage in other coercive practices to secure assent to a non-compete agreements. By threatening discharge to secure an afterthought agreement, the employer can more easily demonstrate that the non-compete was bargained for; the price offered and paid was the employer’s giving up of its immediate

right to terminate. So, rather than limiting an employer's bargaining power, the majority approach may actually sanction this abuse of power.

Moreover, none of the policing approaches suggested by the courts in *Runzheimer*, *Columber*, *Lucht's Concrete*, and *Summits 7* provide an effective check on employer bad faith or overreaching in the afterthought context. The qualification to the majority rule that employment must continue for a substantial period of time addresses only one form of bad faith in the afterthought context, and it does not address the fundamental problem of the employer's superior bargaining position. The suggestion in *Columber* and *Runzheimer* that other defenses—*i.e.*, fraud, duress, breach of the covenant of good faith, or unconscionability—can provide a check on employer bad faith is not persuasive. All of these defenses are either too limited or inapplicable to the problems with the afterthought agreement. The most plausible defense, economic duress, generally requires a wrongful threat and a lack of feasible alternatives.<sup>253</sup> But if an employer has a legal right to discharge an employee-at-will, it is difficult to conceive of an argument that the employer's threat to discharge or use of that power is duress or that the employee is left without a reasonable alternative.<sup>254</sup> Finally, integrating the consideration issue into the reasonableness analysis of the non-compete, as suggested in *Lucht's Concrete*, is difficult both conceptually and from a policy standpoint. How the consideration received by the employee is related to the need for and scope of a non-compete covenant is not clear, nor is it apparent how the consideration calculus would be part of the reasonableness test. Generally, consideration—like protectable interest—should be a threshold issue. Without a valid contract and a protectable interest, a non-compete is unenforceable regardless of how reasonable or limited a restraint is imposed on the employee.

#### VI. AN ALTERNATIVE APPROACH TO THE CONSIDERATION ISSUE IN THE AFTERTHOUGHT AGREEMENT CONTEXT

What is needed is an approach to the afterthought agreement that carefully balances the interests of employers and employees but places the burden on the employer to justify the voluntariness of any

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253. See, e.g., *Oskey Gasoline & Oil Co. v. Cont'l Oil Co.*, 534 F.2d 1281, 1286 (8th Cir. 1976) (citing *W. R. Grimshaw Co. v. Nevil C. Withrow Co.*, 248 F.2d 896, 904 (8th Cir. 1957)) (holding that the party must be left with "no other alternative").

254. See, e.g., *Simko, Inc. v. Graymar Co.*, 464 A.2d 1104, 1108 (Md. Ct. Spec. App.), cert. denied, 469 A.2d 452 (Md. 1983) (finding no duress despite threat to discharge, employee had reasonable alternative because similar jobs were available).

modification of the employment contract. Just as the reasonableness standard of the common law results in the invalidation of voluntarily executed non-compete agreements, the law should impose some constraint on the afterthought agreement, particularly given the potential for the use of unfair bargaining power by employers. While the concern of the law of employee non-competes is primarily with the substance of the agreement, the primary concerns in the afterthought context are with the unfair bargaining power wielded by employers in this setting and the unfair bargaining power's detrimental impact on employee mobility and free competition. Any approach should provide an incentive for an employer to negotiate a non-compete agreement at the inception of the employment relationship and ensure that any agreement secured after the fact is truly voluntary.

On the other hand, any approach to the issue should ensure that employers have the flexibility to adapt employment relationships as business needs change, just as they retain the power to terminate the relationship in response to market conditions. One benefit of the majority rule is that it allows employers to alter the terms and conditions of employment as the employee's responsibilities, knowledge, or experience develops, without legal impediments or unnecessary formalistic requirements. Requiring independent consideration imposes too great a constraint in the modern workplace environment and may be inconsistent with the practical realities of the new information-age employment relationship.

#### A. *Contract Law and Good Faith Modifications*

We believe that the requirement of consideration for an afterthought agreement should ultimately be satisfied if the parties in good faith agree to a non-compete covenant. Such a good faith requirement is consistent with and supported by modern contract and sales law, particularly the limitations on the pre-existing duty rule in article 2-209 of the *Uniform Commercial Code*<sup>255</sup> and under section 89 of the *Restatement (Second) of Contracts*.<sup>256</sup>

Under the common law pre-existing duty rule, the promise to

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255. See U.C.C. § 2-209(1) (AM. LAW INST. & UNIF. LAW COMM'N 1977) ("An agreement modifying a contract within this Article needs no consideration to be binding.").

256. See RESTATEMENT (SECOND) OF CONTRACTS § 89 (AM. LAW INST. 1981) ("A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made . . .").

perform an existing contractual obligation was not sufficient consideration for a modification of a contract.<sup>257</sup> Additional or new consideration is required because the promisor suffers no “legal detriment” by committing to perform that which the promisor was legally obligated to perform, nor does the promisee receive a “legal benefit” from a promise to do that which the promisor was already legally required to do.<sup>258</sup>

The common law rule had the salutary effect of preventing the *hold-up game* and other improper tactics used by contracting parties to secure an additional advantage under a pre-existing contract.<sup>259</sup> The *hold-up game*, as with a contractor who threatens to quit a partially performed contract unless additional compensation is paid, can be used effectively to secure an advantageous modification.<sup>260</sup> A party “coerced” into such a modification by the other party was protected under consideration law and did not have to rely on other more limited defenses, including economic duress. Thus, the common law pre-existing duty provided a check on abusive practices in the modification context.

The pre-existing duty rule has been criticized by commentators and courts.<sup>261</sup> One flaw in the rule is the problem of “changes in

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257. Kevin M. Teeven, *Development of Reform of the Preexisting Duty Rule and Its Persistent Survival*, 47 ALA. L. REV. 387, 388 (1996).

The preexisting duty rule provides that a promise to [perform], or the performance of, an existing legal duty is not valid consideration for a promise. Thus, if a creditor agrees to accept less than the contract amount at the due date, or if a contractor is promised more than the contract amount to complete a project, such promises are not binding. The rule encompasses modifications, accords, and discharges of preexisting duties.

*Id.*

258. *E.g.*, *McCallum Highlands, Ltd. v. Wash. Capital DUS, Inc.*, 66 F.3d 89, 93 (5th Cir.), *opinion corrected on denial of reh'g*, 70 F.3d 26 (5th Cir. 1995).

In general, under the “pre-existing duty rule,” an agreement to do what one is already bound to do cannot serve as “sufficient consideration to support a supplemental contract or modification.” This rule usually comes [into] play when one party becomes unhappy with the contract as agreed upon and wants to change it. He has to offer some new consideration to the other party to induce that other party to agree to the change. Thus, merely offering the preexisting duty he had already contracted to perform cannot serve as consideration for the change.

*Id.* (citations omitted).

259. *See, e.g.*, *Alaska Packers' Ass'n v. Domenico*, 117 F. 99, 103 (9th Cir. 1902) (holding that the promise to pay seamen more money when they refused to work was unenforceable because the seamen were already obligated to perform the work under the original contract).

260. ARTHUR LINTON CORBIN, *CORBIN ON CONTRACTS: A COMPREHENSIVE TREATISE ON THE RULES OF CONTRACT LAW* 105 (West Publ'g Co. 1963). Professor Corbin coined the phrase *hold-up game* to describe situations in which one of the parties to a contract extorts a favorable contract modification by threatening not to perform.

261. *See* Robert A. Hillman, *Policing Contract Modifications Under the UCC: Good Faith and the Doctrine of Economic Duress*, 64 IOWA L. REV. 849, 852 (1979) (“[M]any courts came to

circumstances” surrounding the contract, particularly changes that make it more difficult or costly for a party to perform.<sup>262</sup> Under the pre-existing duty rule, the parties do not have the flexibility to modify merely the contract price to accommodate such detrimental changes. Given the difficulties of anticipating the multitude of market or other circumstances that might impact the profitability of a contract, the pre-existing duty rule limitations on renegotiated contracts may result in considerable unfairness.<sup>263</sup> Moreover, if the primary purpose of the rule is to prevent abusive practices in the renegotiation process, then the rule is considerably overbroad.<sup>264</sup>

Consequently, over time the courts have liberalized the pre-existing duty rule by creating exceptions and qualifications to its application.<sup>265</sup> To address the scenario of changed circumstances justifying a contract modification, many jurisdictions have adopted an exception for unexpected circumstances.<sup>266</sup> The exception for good faith adjustments based on unanticipated changes has been embraced by the *Restatement*

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believe that parties should be permitted to voluntarily alter their agreements because of changes in circumstances. Because the pre-existing duty rule is a roadblock to the free adjustment of contracts, the rule lost favor with courts and commentators . . .”).

262. *Id.*

263. See, e.g., *Meech v. City of Buffalo*, 29 N.Y. 198 (1864) (describing a case where a contractor confronted quicksand during sewer installation).

264. See Daniel A. Graham & Ellen R. Peirce, *Contract Modification: An Economic Analysis of the Hold-Up Game*, LAW & CONTEMP. PROBS., Winter 1989, at 9, 14.

Because of its absoluteness, [the pre-existing duty rule] fails to distinguish between situations in which the party desiring modification is in fact playing a hold-up game and one in which such party is motivated by the discovery of circumstances or the occurrence of unexpected events that makes his performance far more burdensome than originally expected.

*Id.*

265. Hillman, *supra* note 261, at 852–54 (describing theories of rescission, gift, and waiver as “legal fictions” to avoid negatives of the pre-existing duty rule).

266. One of the leading cases is *King v. Duluth, M. & N. Railway*, 63 N.W. 1105 (Minn. 1895). The *King* court enforced a modification under which a contractor was promised additional compensation because of unanticipated problems with construction, stating the requirements of this exception as follows:

What unforeseen difficulties and burdens will make a party’s refusal to go forward with his contract equitable, so as to take the case out of the general rule and bring it within the exception, must depend upon the facts of each particular case. They must be substantial, unforeseen, and not within the contemplation of the parties when the contract was made. They need not be such as would legally justify the party in his refusal to perform his contract, unless promised extra pay, or to justify a court of equity in relieving him from the contract; for they are sufficient if they are of such a character as to render the party’s demand for extra pay manifestly fair, so as to rebut all inference that he is seeking to be relieved from an unsatisfactory contract, or to take advantage of the necessities of the opposite party to coerce from him a promise for further compensation.

*Id.* at 1107.

(*Second*) of *Contracts* under section 89, which provides in part: “A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made . . . .”<sup>267</sup>

The most significant departure from the common law has come with the adoption of article 2 of the *Uniform Commercial Code* (UCC). The drafters of the UCC abolished the pre-existing duty rule for sales contracts in section 2-209(1), which reads: “An agreement modifying a contract within this Article needs no consideration to be binding.”<sup>268</sup> The clear purpose of the rule was to allow parties the flexibility to freely modify their sales contracts, with or without new consideration. The practical necessities of an efficient marketplace demanded the break with the formalism of the common law.

But the UCC drafters also recognized the problems with coerced modifications under the *hold-up game* scenario, and the comments to section 2-209 qualified the language of the section.<sup>269</sup> The UCC’s requirement of good faith prevents the unfair use of a party’s bargaining position either to secure a modification that is not truly voluntary or one that is not supportable by “legitimate commercial reason[s].”<sup>270</sup>

Courts interpreting section 2-209 have fashioned standards that operationalize the section 2-209 comments regarding good faith.<sup>271</sup> One of the leading cases is *Roth Steel Products v. Sharon Steel Corp.*<sup>272</sup> The case involved a typical scenario in which a supplier, Sharon Steel, “renegotiated” a sales contract because of changes in market conditions by threatening not to honor its delivery obligations.<sup>273</sup> In determining whether there was good faith modification, the court developed a two-part test:

The first inquiry is relatively straightforward; the party asserting the modification must demonstrate that his decision to seek modification

267. RESTATEMENT (SECOND) OF CONTRACTS § 89 (AM. LAW INST. 1981).

268. U.C.C. § 2-209(1) (AM. LAW INST. & UNIF. LAW COMM’N 1977).

269. *Id.* § 2-209 cmt. 2 (“[M]odifications made [under subsection (1)] must meet the test of good faith imposed by this Act.”).

270. *Id.*

271. *E.g.*, *T & S Brass & Bronze Works, Inc. v. Pic-Air, Inc.*, 790 F.2d 1098, 1105 (4th Cir. 1986) (stating that good faith requires a “legitimate commercial reason” for a modification request, one that is “outside the control of the party seeking the modification”). *See also* *Weisberg v. Handy & Harman*, 747 F.2d 416, 420 (7th Cir. 1984) (considering a “precipitous change in market price” as a legitimate commercial reason to seek contract modification in good faith under § 2-209).

272. 705 F.2d 134 (6th Cir. 1983).

273. *Id.* at 138–39.

was the result of a factor, such as increased costs, which would cause an ordinary merchant to seek a modification of the contract. The second inquiry, regarding the subjective honesty of the parties, is less clearly defined. Essentially, this inquiry requires the party asserting the modification to demonstrate that he was, in fact, motivated by a legitimate commercial reason and that such a reason is not offered merely as a pretext. Moreover, the trier of fact must determine whether the means used to obtain the modification are an impermissible attempt to obtain a modification by extortion or overreaching.<sup>274</sup>

Applying this two-part good faith test, the court found that Sharon Steel met the first part because it was facing substantial future losses on its contracts and because the change in market conditions would cause “an ordinary merchant to seek a modification.”<sup>275</sup> However, the threat to stop selling steel unless Roth Steel agreed to the modification was considered bad faith under the second prong of the test. Although “coercive conduct” is evidence of bad faith, the court noted that “showing may be effectively rebutted by the party seeking to enforce the modification.”<sup>276</sup> Sharon Steel argued that the presumption was rebutted because it was allowed to raise its prices under the terms of the original contract.<sup>277</sup> But the court found that the contract language could not be so construed, and Sharon Steel had never asserted its contract rights as justification for its threat to cease deliveries.<sup>278</sup>

Good faith has an objective (or substantive) and subjective (or process) component under modern consideration law. For a good faith modification, the party benefiting from the change must demonstrate a reasonable commercial justification for the modification. Under the *Restatement (Second) of Contracts*, the objective or substantive part of the good faith standard—unanticipated circumstances—is more restrictive than under section 2-209. But under both tests, the commercial reason for the modification is part of the calculus. The subjective or process component focuses on the “actual” reason for seeking a modification and the means used to secure the modification. This element ensures that proffered justifications are not a pretext to secure an unreasonable modification and that the modification was not coerced by improper threats.

The standards developed by the courts under section 2-209 and the

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274. *Id.* at 146 (citations omitted).

275. *Id.* at 147.

276. *Id.* at 148.

277. *Id.*

278. *Id.*

Restatements provide a general framework for our proposed good faith requirement in the afterthought context. We believe that this two-part framework can be adapted to the non-compete setting. As the next section demonstrates, some courts have developed good faith standards in regard to the reformation of an overbroad non-compete agreement. Those standards provide a useful parallel to the analogous case of the afterthought agreement.

### B. *Good Faith and the Reformation of Non-Compete Agreements*

Traditionally, the common law permitted the partial enforcement of an overbroad non-compete agreement only under limited circumstances, if at all. In some jurisdictions, an overbroad non-compete was considered *void per se*, and the courts refused to permit enforcement in any way.<sup>279</sup> This continues to be the rule in Wisconsin by statute.<sup>280</sup> In other jurisdictions, courts permitted partial enforcement under the *blue pencil* doctrine. However, the formalistic *blue pencil* doctrine allowed enforcement only when it was grammatically possible to sever the language of the non-compete clause, but it did not empower the courts to change the non-compete agreement.<sup>281</sup>

In the modern era, there has been a distinct movement from the *blue pencil* doctrine to a rule of reformation.<sup>282</sup> Both by statute and court decision, courts have been empowered to rewrite the terms of a non-compete agreement and to enforce it as reformed.<sup>283</sup> Reformation is

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279. For a discussion of the *void per se* rule and the *blue pencil* doctrine, see *Solari Industries, Inc. v. Malady*, 264 A.2d 53, 55–57 (N.J. 1970) (allowing reformation of an overbroad non-compete to render it enforceable).

280. See WIS. STAT. § 103.465 (2012) (“Any covenant, described in this subsection, imposing an unreasonable restraint is illegal, void and unenforceable even as to any part of the covenant or performance that would be a reasonable restraint.”). *But see* S.B. 69, 102nd Leg., Reg. Sess. (Wis. 2015–2016) (proposing legislation that “repeals current law relating to covenants not to compete and instead creates a new provision relating to restrictive covenants in employment and agency relationships”).

281. See, e.g., *Hartman v. W.H. Odell & Assocs., Inc.*, 450 S.E.2d 912, 920 (N.C. Ct. App. 1994) (noting severe limits on court’s power to alter the contract under the *blue pencil* doctrine).

282. E.g., *BDO Seidman v. Hirshberg*, 712 N.E.2d 1220 (N.Y. 1999).

283. State statutes in Florida, Michigan, and Texas specifically empower courts to reform unreasonable employee agreements not to compete. See FLA. STAT. § 542.335(1)(c) (2013) (“If a contractually specified restraint is overbroad, overlong, or otherwise not reasonably necessary to protect the legitimate business interest or interests, a court shall modify the restraint and grant only the relief reasonably necessary to protect such interest or interests.”); MICH. COMP. LAWS § 445.774a(1) (2011) (“To the extent any such agreement or covenant is found to be unreasonable in any respect, a court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited.”); TEX. BUS. & COM. CODE ANN. § 15.51(c) (2011) (“[T]he court shall reform the covenant to the extent necessary to cause the



considered a superior policy approach because it allows the courts to enforce a reasonable agreement not to compete consistent with the reasonable expectations of the parties.<sup>284</sup>

As with the afterthought agreement, courts adopting the rule of reformation have been concerned about the potential for employer abuse.<sup>285</sup> In this context, the primary concern is with employer overreaching. Employers may be tempted to draft onerous, overbroad non-compete agreements on the assumption that there is no penalty for such conduct, other than reformation of the agreement; but the agreement still provides possible benefits in terms of restricting former employees contemplating competitive activities.<sup>286</sup>

As a result of this potential for employer overreaching, courts following the rule of reformation may refuse to reform and enforce a non-compete agreement when an employer intentionally drafts an overbroad agreement or otherwise acts in bad faith.<sup>287</sup> This is the position of the Restatement, and it has considerable legitimacy in the non-compete area.<sup>288</sup>

Courts in several recent opinions have developed demanding standards to assess good faith in the reformation setting. In *Merrimack Valley Wood Products, Inc. v. Near*,<sup>289</sup> the New Hampshire Supreme Court addressed the reformation of a non-compete agreement that restricted Near, a former salesperson, from selling goods to any customer of his former employer for a period of one year after termination of employment.<sup>290</sup> The agreement was deemed overbroad because the employer had over 1,200 customers, and the employee serviced only sixty of these customers.<sup>291</sup> The trial court refused to reform the non-compete agreement based on the bad faith of the employer.<sup>292</sup> During the hiring process, the employer never informed Near that he would be required to sign a non-compete covenant.<sup>293</sup> Only after working for six

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limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable . . .”).

284. *Raimonde v. Van Vlerah*, 325 N.E.2d 544, 546–47 (Ohio 1975).

285. *See, e.g., Data Mgmt., Inc. v. Greene*, 757 P.2d 62, 65 (Alaska 1988) (recognizing potential for overreaching, but relying on good faith requirement to check that problem).

286. *See, e.g., Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310 (N.H. 1979).

287. *See id.* at 1311.

288. *See* RESTATEMENT (FIRST) OF CONTRACTS §§ 513–15 (AM. LAW INST. 1932).

289. 876 A.2d 757 (N.H. 2005).

290. *Id.* at 760.

291. *Id.* at 763.

292. *Id.* at 761.

293. *Id.* at 760.

months, Near was presented with the non-compete agreement and informed that his continued employment was contingent upon his signing the contract.<sup>294</sup>

Although this was an afterthought agreement, the court did not address the issue of consideration. Rather, in refusing to grant reformation, the court found bad faith on the part of Merrimack Valley in securing the overbroad non-compete agreement.<sup>295</sup> The court agreed that the lack of advance notice was not the same as bad faith, but other facts supported the trial court's judgment.<sup>296</sup> These included the delay of six months in presenting the agreement to Near as well as the coercion in securing his consent.<sup>297</sup> His consent to the afterthought agreement was necessary for him to retain his position, and the trial court concluded that he was in "no position to decline" the employer's demand.<sup>298</sup>

The *Merrimack Valley* court focused on the negotiating process and the means by which the employer secured consent to the overbroad non-compete agreement. The court could have analyzed the good faith of the employer from a substantive standpoint, but conflicting precedents in New Hampshire law created a lack of clarity on the permissible scope of a non-compete designed to protect goodwill interests.<sup>299</sup>

In *Freiburger v. J-U-B Engineers, Inc.*,<sup>300</sup> the Idaho Supreme Court refused to reform an overbroad non-compete agreement based on the substance of the agreement. As in *Merrimack Valley*, the non-compete agreement was unreasonably overbroad. The non-compete covered the entire client base of the employer, a large group of past and present clients that the employer had serviced throughout the Northwest in its thirty years of operation, and it restricted the employee from providing any services or doing work in any capacity for any of the employer's "past, present or potential client[s]."<sup>301</sup>

The *Freiburger* court declined to reform the agreement because of the unreasonableness of the restriction and the need for the court to essentially rewrite the entire covenant.<sup>302</sup> The court stated that the covenant was "so lacking in the essential terms which would protect the

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294. *Id.*

295. *Id.* at 765.

296. *Id.* at 764–65.

297. *Id.* at 765.

298. *Id.*

299. *See id.* at 764.

300. 111 P.3d 100 (Idaho 2005).

301. *Id.* at 106–07.

302. *Id.* at 108.

employee' such that the trial court is no longer modifying but rewriting the covenant."<sup>303</sup> Although the court did not use the language of good faith, the holding restricted the judicial power of reformation when an employer in bad faith overreaches with a non-compete covenant that is facially overbroad and excessive.

## VII. A GOOD FAITH STANDARD FOR THE AFTERTHOUGHT AGREEMENT

### A. *Our Proposed Good Faith Test*

We believe that a voluntariness requirement can be fashioned in the employment setting that parallels the standards for good faith under section 2-209 and those adopted by courts in the reformation setting—standards that would allow good faith afterthought agreements without the necessity of independent consideration. We propose a two-prong test for good faith in the afterthought context. The substantive component would consider the business justification for the afterthought agreement, including changes in the employment relationship necessitating the non-compete covenant and the extent to which the employer was seeking a non-compete covenant based on legitimate protectable interests in the protection of trade secrets or customer relationships. The process component of the good faith standard would primarily focus on the negotiation process, including the means by which the employer secured the employee's assent to the non-compete agreement.

The *substantive component* of our good faith standard recognizes that changing business conditions and the evolution of employment relationship over time can justify an employer's request for a non-compete agreement during the course of employment. Frequently, an employee working with clients or customers will gradually develop personal relationships with those persons—relationships that can be exploited and used to divert the goodwill of his or her employer if the employee starts a competing business or works for a direct competitor. *Poole* is an example of this common scenario. The non-compete was presented to the travel agency employee three and a half years after she commenced employment, arguably because she had by then established customer relationships that could have been exploited if she competed with the agency. In fact, *Poole* sued to recover costs associated with the transfer of cruise bookings with those customers, and the travel agency

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303. *Id.* (citing *Pinnacle Performance, Inc. v. Hessing*, 17 P.3d 308, 313 (Idaho Ct. App. 2001) (quoting *Ins. Ctr., Inc. v. Taylor*, 499 P.2d 1252, 1256 (Idaho 1972))).

defended itself based on the non-compete agreement she signed. An employer who presents a non-compete agreement months or even years after employment commenced based on this change in employment circumstances is acting in good faith from a substantive standpoint.

In contrast, an employer is not acting in good faith if the employer presents an overbroad non-compete after employment has commenced without a legitimate protectable interest at risk. *Maw* is exemplary of this scenario: an overbroad non-compete presented to an employee simply because of a change in corporate policy that dictated a non-compete agreement from any employee at a particular level of the organization. *Labriola* presents a similar scenario. There, the employee was already burdened by a non-compete when the employer—who was facing financial difficulties—presented him with a broader restrictive covenant for no apparent business reason. This suggested that the actual purpose for the afterthought agreement was to restrict his future employment opportunities and potential competitive activities. Finally, an afterthought agreement that is facially or substantially overbroad as in *Summits 7* and *Freiburger* should trigger heightened judicial scrutiny of the employer's good faith.

Independent consideration also is an important factor in the substantive component of good faith but should not be determinative as it is under the minority rule. Some courts following the minority approach allow an employer to satisfy the independent consideration requirement with a token consideration.<sup>304</sup> Under our approach, as under section 2-209,<sup>305</sup> nominal consideration provided an employee may not be sufficient if other elements of bad faith are present. On the other hand, when an employee receives a promotion—a *bona fide advancement*—specialized training, or access to trade secrets, the substantive element of the good faith standard should be satisfied.

The *process component* of the good faith standard would consider factors relevant to the *cubewrap contract* cases, including whether the employee was apprised of the required non-compete agreement before the commencement of the relationship and whether the employee has changed his or her position because of the employer's delay in presenting the non-compete agreement. Lack of notice may be suggestive of but does not necessarily establish bad faith, as the *Merrimack Valley* court

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304. See, e.g., *Hejl v. Hood, Hargett & Assocs., Inc.*, 674 S.E.2d 425, 428–29 (N.C. Ct. App. 2009) (holding that \$500 was sufficient consideration for a two-year non-compete agreement).

305. U.C.C. § 2-209 cmt. 2 (AM. LAW INST. & UNIF. LAW COMM'N 1977) (“Nor can a mere technical consideration support a modification made in bad faith.”).

concluded. In some industries and professions non-compete agreements are customary, and prospective employees may otherwise be aware that their new employers will request a standard non-compete agreement.

Lack of notice coupled with other factors may support a finding of bad faith. In *Merrimack Valley*, the non-compete was not discussed at the interview or hiring stage, and the employee was provided a pricing book with sensitive proprietary information without any confidentiality, non-solicitation, or non-compete agreement—facts that may have suggested to the employee that no such covenant was required. Similarly, a delay in presentment of a non-compete that results in an employee changing his position is another factor in the process element of good faith. An employee who quits his job and moves his family before being apprised of the need for a non-compete is placed in a different and weakened bargaining position and may feel compelled to sign an agreement, the existence or terms of which the employee may have objected to or attempted to negotiate prior to the decision to accept employment.<sup>306</sup>

The nature of the negotiating process is also critical to the process component of good faith. Good faith assumes a *voluntary* modification of the employment relationship. Consequently, bad faith would be presumed if the employer threatened discharge or engaged in other coercive actions to secure the consent of the employee. Express or implied threats to discharge should clearly be discouraged, and cases like *Maw* involving refusals to negotiate, threats to discharge, and overbroad non-compete agreements present the most compelling cases of bad faith. As under section 2-209, however, we suggest that an employer can rebut this presumption for several reasons.

First, whether an employer has “threatened” discharge is a difficult factual determination. Employees may be inclined to understand that they must sign a non-compete or simply believe that they have to sign or be discharged, as in the *Labriola* case. In such ambiguous cases, courts should consider the facts surrounding the employee’s understanding as part of the overall good faith analysis. Second, even when the employee is presented with a sign-it-or-leave choice, other elements of good faith may counterbalance that pressure. Thus, an employee presented with a reasonable non-compete as a condition of a promotion to a high-level, sensitive position in an organization may be “compelled” to accept the

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306. See, e.g., *Schneller v. Hayes*, 28 P.2d 273, 274 (Wash. 1934) (presenting a scenario where an employee quit his job, moved his family to Washington from Montana, and a non-compete agreement was executed shortly after the employee started working but was not discussed at the time of hire).

non-compete covenant, but the good faith standard could be satisfied. Thus, substantial consideration in the form of a promotion or advancement may be sufficient to rebut the presumption of bad faith in these types of scenarios.

*B. Our Good Faith Test in Practice*

How would the good faith standard operate in practice? No court has embraced a good faith standard, but the Minnesota Supreme Court's seminal decision in *Davies & Davies Agency, Inc. v. Davies*<sup>307</sup> came close to adopting a good faith standard. *Davies* is the leading case in Minnesota adopting the minority rule that continuation of employment is not sufficient consideration for the afterthought agreement. Nevertheless, a careful reading of the *Davies* opinion reveals a more nuanced approach to the consideration issue, one that in both policy and result is in line with our proposed good faith standard.

*Davies* involved a consolidated appeal in which *Davies & Davies Agency, Inc.* (the agency), an insurance agency, sought to enforce non-compete agreements against two former employees, Richard Davies and Robert Buckingham.<sup>308</sup> The court concluded that the afterthought agreement executed by Richard Davies was enforceable as modified by the trial court, but the afterthought agreement signed by Buckingham was unenforceable due to a lack of consideration.<sup>309</sup> Interestingly, in neither case was there independent consideration.

The Richard Davies appeal involved a bitter dispute between the owner of the agency, Everett Davies, and his eldest son, Richard Davies. Richard joined his father's firm when he was twenty years old, initially doing clerical work for the firm.<sup>310</sup> His father wanted one of his sons to succeed him in the business, and Richard was groomed for that succession.<sup>311</sup> In 1967, four months after he began work, Richard was presented with a five-year non-compete agreement that precluded him from engaging in the insurance business within a fifty-mile radius of Minneapolis, St. Paul, or Duluth, Minnesota.<sup>312</sup> The non-compete agreement was not discussed at the time of hire, and Everett allegedly

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307. 298 N.W.2d 127 (Minn. 1980).

308. *Id.* at 128.

309. *Id.* at 133.

310. *Id.* at 129.

311. *Id.*

312. *Id.*

informed Richard that it was a mere formality.<sup>313</sup> Subsequent thereto, Richard received extensive training and experience in probate and court bonds, and by 1972 was running that part of the agency's business.<sup>314</sup> Unfortunately, Richard's relationship with his father deteriorated over the years and became so strained that his father terminated him in 1978 after discovering his intent to resign.<sup>315</sup> The agency sued to enforce the non-compete agreement based on Richard's diversion of clients to another agency.<sup>316</sup>

The *Davies* court, in its discussion of the majority and minority rules on consideration, was clearly sensitive to the bargaining position of an employee in the afterthought context, stating:

[A]n employee frequently has no bargaining power once he is employed and can easily be coerced. . . . [I]n such cases there is a danger that an employer does not need protection for his investment in the employee but instead seeks to impose barriers to prevent an employee from securing a better job elsewhere.<sup>317</sup>

Thus, the court recognized both the substantive and procedural issues with afterthought agreements, and its resolution of the case reflects the resolution of these two aspects of our good faith standard.

In the Richard Davies appeal, the court found the necessary consideration in the leadership role, training and support Richard received, none of which were expressly bargained for at the time the contract was signed. In essence, the court read into the employment relationship a commitment on the part of the agency to give Richard a "successor-track" position and the training and education to support his advancement in the agency. In that sense, the conclusion is consistent with the substantive element of our proposed good faith standard although the breadth of the non-compete agreement in terms of time and scope would have triggered scrutiny under our test.

In the Buckingham appeal, there was strong evidence of bad faith. Buckingham was "successfully employed" in the industry, and he became interested in working for the agency only because he was promised an ownership interest in the business.<sup>318</sup> After his fallout with Richard, Everett promised Buckingham one percent of the business and

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313. *Id.*

314. *Id.*

315. *Id.* at 129–30.

316. *Id.* at 130.

317. *Id.*

318. *Id.* at 132.

an option to acquire a controlling interest in the firm. The parties executed a non-binding letter of intent to memorialize this understanding.<sup>319</sup> Relying on the promises of a majority equity share, Buckingham quit his previous employment and joined the agency in February of 1977.<sup>320</sup> Eleven days after he started work, Everett presented him with a non-compete agreement that Buckingham grudgingly signed with the proviso that his consent to the non-compete agreement was based on the letter of intent.<sup>321</sup> Despite repeated requests for Everett to honor the letter of intent, the sale was never finalized.<sup>322</sup> Because of Everett's failure to live up to his promises, Buckingham left the agency in June of 1978 and engaged in competitive activities within the scope of the non-compete agreement.<sup>323</sup>

The court concluded that there was no consideration for the agreement that Buckingham had signed, in part because Buckingham did not have an opportunity to examine the restrictive covenant during the employment negotiations, and he was threatened with discharge if he did not sign it.<sup>324</sup> Rather than rely exclusively on the lack of independent consideration, the court's analysis of the factual context of the non-compete agreement reflects the process element of our proposed good faith standard. Although Buckingham knew that he would be required to sign a non-compete agreement, the facts surrounding its execution indicate bad faith on the part of Everett Davies. This includes the lack of any true negotiation of the non-compete agreement, the delay in presenting the non-compete until after Buckingham quit his prior position and commenced employment, and the detrimental reliance and change in negotiating position that it caused. The court could also have relied on Buckingham's reliance on the letter of intent and Everett's promise to grant Buckingham an opportunity to purchase a controlling interest in the business.

The process element of the good faith determination in the Richard Davies matter is less clear because the facts are more ambiguous. Unlike Buckingham, however, Richard was not experienced in the industry and fully employed. Thus, Richard suffered no detrimental reliance, nor was he placed in a weakened negotiating position as a result of the timing of the non-compete agreement. Moreover, the delay in presenting the non-

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319. *Id.*

320. *Id.* at 133.

321. *Id.*

322. *Id.*

323. *Id.*

324. *Id.*



compete to Richard does not appear to have been a tactical maneuver on his father's part. In fact, Everett mistakenly believed his son's age—twenty years old—rendered any contract with him unenforceable and did not require the non-compete when Richard started working for the agency.<sup>325</sup> Finally, there does not appear to have been any coercion in securing Richard's consent to the agreement through a threat to discharge or other bad faith, as with Everett's promise in the Buckingham case.

*Davies* provides an illustrative example of the good faith standard in action. Good faith will require a court's probing, pragmatic analysis of the facts and context of the afterthought agreement. It also requires an analysis of the afterthought agreement from the employer's and employee's perspective, which ultimately involves the business interests at risk and the fairness of the negotiation process.

#### VIII. CONCLUSION

Our proposed good faith standard provides an equitable result when an afterthought agreement is truly voluntary but lacks the separate consideration required under the minority rule. Also, by focusing on good faith rather than continued employment, our approach directly addresses the problem with the afterthought agreement—the potential use of unfair bargaining power by employers. We believe that the proposed rule serves to protect employees from unfair bargaining power and bad faith while preserving the autonomy of employers to adapt their employment relationships to protect their business assets.

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325. *Id.* at 129.