

## EMPLOYMENT, LABOR & BENEFITS LEGAL UPDATE



*In this Legal Update*

July 14, 2010

### Wisconsin Courts Set Forth Clarifying Law Regarding Enforceability of Employee Non-Compete Agreements

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**E**nforcing non-compete provisions in employment agreements is of the utmost concern to employers when attempting to protect their business from former employees. However, because a non-compete provision is considered a “restrictive covenant,” they are disfavored by the courts and construed in favor of employees. Further, a non-compete provision can only impose a limitation to the degree needed to protect the employer’s legitimate business interests. If a non-compete provision goes beyond what is necessary to protect an employer’s legitimate business interests, the provision will be ruled void in its entirety and the employer will not be able to enforce any provision of it against the employee. Therefore, non-compete provisions must be carefully drafted if they are to withstand challenge. As noted below, recent Wisconsin case law has clarified what is and what is not enforceable in a non-compete provision.

*Star Direct, Inc. v. Dal Pra* – Restriction Prohibiting Employee from Engaging in a “Substantially Similar” Business Is Unenforceable.

In *Star Direct, Inc. v. Dal Pra*, the Wisconsin Supreme Court reviewed a common non-compete provision. In this case, an employer and employee entered into an employment agreement with a non-compete provision containing multiple restrictive clauses. The provision placed the following three types of restrictions on the employee: (1) for two years after termination of employment, the employee could not solicit current customers of the employer or former customers in the previous year (the “customer clause”); (2) the employee could not work for an employer conducting a “substantially similar” business or a competing business within a 50-mile radius of the employee’s sales territory (the “business clause”); and (3) the employee was prohibited from disclosing certain confidential and proprietary information to others (the “confidentiality clause”).

The Supreme Court found that the customer and confidentiality clauses were enforceable restrictive covenants. Regarding the customer clause, the Court clarified that a business has a legitimate interest in prohibiting the solicitation of recent past customers. Regarding the confidentiality clause, the Court found that the employee would have a significant advantage with the special knowledge gained from his employment, which could be damaging to his former employer if that knowledge was used for the benefit of a competitor.

The business clause was found to be unenforceable because it prohibited the employee from engaging in a “substantially similar business.” The Supreme Court found that preventing a former employee from engaging in a “substantially similar business,” that may not be

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competitive with the former employer's business, is not necessary for the employer's protection. The lack of a protectable interest in this regard made the business clause unreasonable and unenforceable.

The Supreme Court next turned to the issue of whether the unenforceable business clause voided the two enforceable clauses as well. In Wisconsin, if a non-compete clause contains multiple clauses, such as the non-compete provision in Star Direct, and one is found to be unenforceable, then the others will also be unenforceable unless the clauses are divisible. To determine whether a clause is divisible from another clause, a court will evaluate whether the enforceable clause may be understood and independently enforced if the unenforceable portion is stricken from the agreement.

The Supreme Court found that since each clause dealt with separate interests, compliance with one did not depend on compliance with another. Also, since the clauses could be read and understood separately, the three clauses were found to be divisible. Therefore, the employer was able to enforce the customer and confidentiality clauses, even though the business clause was unenforceable.

Permitting an employer to enforce the enforceable parts of a non-compete provision when one part is found to be unenforceable is a new development in Wisconsin law. This development will benefit Wisconsin employers because it means that all may not be lost when a portion of a non-compete provision is found to be unenforceable in some respect.

*Frank D. Gillitzer Electric Co, Ltd. v. Marco Anderson et. al.* – An Unenforceable Non-Compete Clause May, But Does Not Necessarily, Void Other Provisions In An Employment Agreement.

In January of 2010, the Wisconsin Court of Appeals reviewed a case dealing with the divisibility issue that was raised in Star Direct when one of the provisions is not a restrictive covenant. In *Frank D. Gillitzer Electric Co., Ltd. v. Marco Anderson et. al.*, the Court of Appeals reviewed agreements between an employer, an electric contractor, and five former employees. The agreements included a non-compete provision and a training repayment provision. In accord with the repayment provision, the employer paid the costs for the employees to enter into a training program to become licensed electricians. However, if the employees failed to complete the program, they were required to reimburse the employer for the cost of the training program (the "repayment clause"). In addition, the employees were prohibited from becoming employed by a competing business for four years after leaving the employer (the "non-compete clause"). All of the employees dropped out of the training program and resigned from their employment. The employer wished to recover the costs of the training program.

The employer acknowledged that the non-compete provision was unenforceable (courts generally find that anything over two years in duration in a non-compete provision is unreasonable). Based on that, the employees argued that the repayment clause was so intertwined with the invalid non-compete clause that it should be stricken from the agreement. The Court of Appeals found, however, that the non-compete provision and the repayment clause were distinct, and could be read separately without loss of meaning. That is, the repayment clause was not found to be intertwined with the unenforceable non-compete clause to such a degree that it rendered the repayment clause unenforceable. Therefore, the employer could enforce the repayment clause against the employees and recover the training costs.

The Gillitzer Electric case demonstrates it is prudent to structure all provisions of an employment agreement as separate and distinct provisions from any non-compete provision so that if a non-compete provision is found to be unenforceable, the other provisions will still be valid and enforceable.

*H & R Block Eastern Enterprises v. Swenson et. al.* – Clauses Extending The Duration Of Non-Compete Provisions Can Render Them Unenforceable.

Some non-competition provisions call for the extension of the duration of the non-compete provision for the amount of time that a violation has occurred. In *H & R Block Eastern Enterprises v. Swenson et. al.*, the Wisconsin Court of Appeals reviewed the enforceability of an extension of the duration of a non-compete provision in an employment agreement when the extension was triggered by a violation.

In *H & R Block*, a group of employees left H & R Block to set up their own competing business. H & R Block sued the employees claiming they violated the non-compete and non-solicitation clauses in their employment agreements. These clauses set forth a provision that automatically extended the duration of the restrictions against the employees when a breach of the non-compete provision occurred by the length of time of the violation.

The Court of Appeals found that the extension clause was ambiguous because the actual duration of the non-compete provision could not be predicted. The Court found that since the extension provision was unclear, the duration of the entire non-compete provision was unreasonable and, therefore, the non-compete provision was unenforceable.

### Conclusion

The above recent cases provide valuable lessons for employers who wish to impose and enforce non-compete provisions. In Wisconsin, an employer should ensure that if a non-compete provision contains multiple restrictive covenant requirements (i.e., non-compete, non-solicitation, confidentiality, etc., provisions), as in the *Star Direct* and *Frank D. Gillitzer* cases, they are set forth in separate and distinct clauses. In addition, employers should ensure that their non-compete provisions do not prohibit an employee from being employed by a non-competing company that is in a substantially similar business because the employer may have no legitimate interest in prohibiting the employee from working for that company.

Another lesson to be learned from the Wisconsin cases is that any provision in a non-compete provision that extends the duration of the provision because of a violation will be highly scrutinized by a court and may very well be found invalid. If so, the extension provision may render the entire non-compete provision unenforceable. Thus, in most cases, it is best not to include any extension provision and, rather than doing so, include the maximum duration time limit permissible by law.

If you have questions regarding the above, please contact Jeff Jones or Terri Smith, the authors of this article, or any of the attorneys in the Employment, Labor & Benefits Practice Group of Ruder Ware: Ron Rutlin, Dean Dietrich, Mary Ellen Schill, Chris Toner, or Sara Ackermann. 📧

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Attorneys in the group regularly represent public and private sector employers in collective bargaining, negotiations, union elections, unfair labor practices, and grievance arbitration matters in addition to guiding nonunion clients on maintaining their union-free status.

Actively involved in organizations with human resource professionals as the primary member base, our attorneys are in tune with the various sensitivities and complexities of the profession. Our attorneys often present seminars and in-house training on employment law topics both across the state and nationwide.

Areas of practice by the Employment, Labor & Benefits practice group:

- Employee Benefits & Executive Compensation
- Employment Law
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**Ruder Ware**

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