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This article provides a guide for best practices for the enforcement of noncompetition agreements and restrictive covenants in select states and federal circuits throughout the US. These contracts are used routinely by businesses to protect goodwill, client relationships, trade secrets, confidential and proprietary information, and to develop a competitive advantage. You will learn about the pitfalls and advantages of such contracts, as well as legal trends in select jurisdictions.

Also in this issue, many companies do not develop IP themselves, but instead rely on licenses to use the IP. But what happens to a licensee's rights if the licensor files bankruptcy? Can the licensee's rights be terminated? Can another entity step into the shoes of the licensee? Changes to the bankruptcy code deal with these issues and demonstrate that the code can be used as a sword, and not just a shield for those that find themselves dealing with this thorny issue.

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A Limited Survey of Best Practices for Enforcement of Noncompete Agreements and Restrictive Covenants

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Noncompetition agreements are used routinely by businesses in the United States to protect goodwill, client relationships, trade secrets, confidential and proprietary information, and to develop a competitive advantage.

The validity and enforceability of noncompetition agreements varies according to the jurisdiction of the particular state or federal circuit court.

This article will survey a limited number of states and federal circuits concerning the use and enforcement of noncompetition agreements. The following jurisdictions will be examined: The First Circuit, the state of Massachusetts, the state of Maine, the Second Circuit, the state of New York, the Ninth Circuit, and the states of California and Oregon. In each jurisdiction, we will explore the standard aspects of non-competes that courts generally consider, including: reasonableness; duration; protectable interests; modification; and, in some instances, the way that noncompetes are applied in the context of specific professions.

First Circuit

Restrictive covenants "upon an employee's exercise of a gainful occupation after leaving the employer are, and were at common law considered to be, void as in restraint of trade." *Am Eutectic Welding Alloys Sales Co., Inc., v. Rodriguez*, 480 F.2d 223, 228 (1st Cir. 1973). However, a court will allow a restrictive covenant or a noncompetition agreement "if

the restriction is reasonable, and not wider than is necessary for the protection to which the employer is entitled[.]" *Id.* (Internal quotation marks and citation omitted.) If there is a valid non-solicitation agreement "and an employee departs for greener pastures, the employer ordinarily has the right to enforce the covenant according to its tenor." *Corporate Technologies v. Hartnett*, 731 F.3d 6, 8 (1st Cir. 2013).

Reasonableness

An overly-broad noncompetition agreement "is enforceable to the limited extent reasonable." *Am Eutectic Welding Alloys Sales Co., Inc.,* 480 F.2d at 227 (1st Cir. 1973). Whether an agreement is "reasonable" depends on the facts and circumstances of each case. *Ferrofluidics Corp. v. Advanced Vacuum Components, Inc.*, 968 F.2d 1463, 1468-69, 1470 (1st Cir. 1992). The "appropriate inquiry" is "whether the employer has exploited an inherent imbalance by placing deliberately unreasonable and oppressive restraints on the employee." *Id.* at 1470.

Duration

Time period must be "reasonable". *Corporate Technologies ,* 731 F.3d at 8. Five years is generally too long. *Ferrofluidics Corp.*, 968 F.2d at 1469.

Protectable Interests

Goodwill, *Corporate Technologies*, 731 F.3d at 8; customer lists, *id.*; confidential information, *id.* at 14; and trade secrets, *Lanier Prof'l Services, Inc., v. Ricci*, 192 F.3d 1, 5 (1st Cir. 1999), are recognized as protectable interests. However, a noncompetition agreement "cannot make secret that which is not secret[.]" *Id.* at 5 (internal citation and quotation marks omitted).

"The line between solicitation and acceptance of business is a hazy one, and the inquiry into where this line should be drawn in a particular case is best executed by the district court." *Corporate Technologies*, 731 F.3d at 10. Whoever first makes contact "is just one factor among many that the trial court should consider in drawing the line between solicitation and acceptance in a given case." *Id.* at 12.

Modification

A court may modify an overly-broad noncompetition agreement, and the agreement is unenforceable until it is modified. *Astro-Med, Inc., v. Nihon Kohden America, Inc*., 591 F.3d 1, 14 (1st Cir. 2009). Once an agreement has been narrowed by the court, "the breaching party is being held to a more narrowly circumscribed agreement than the one he signed, and the more restrictive terms of the agreement remain as effective as the day they were agreed to." *Id.* at 15.

Massachusetts

In deciding whether to enforce a particular agreement, a court considers whether the noncompete "(a) is necessary to protect a legitimate business interest of the employer,

(b) is supported by consideration, (c) is reasonably limited in all circumstances, including time and space, and (d) is otherwise consonant with public policy." *Bowne of Boston, Inc. v. Levine*, 1997 WL 781444, at *2 (Mass. Super. Nov. 25, 1997).

Whether the employee or the employer is granted deference in the context of a restrictive covenant or a noncompete can vary in Massachusetts. For example, according to the Supreme Judicial Court of Massachusetts, "[e]mployees occupying positions of trust and confidence owe a duty of loyalty to their employer and must protect the interests of the employer." *Chelsea Indus., Inc. v. Gaffney*, 449 N.E.2d 320, 326 (Mass. 1983). In that case, the court also explained that an employee "is bound to act solely for his employer's benefit in all matters within the scope of his employment". *Id.* Furthermore, the court in that case explained that an "executive employee is barred from actively competing with his employer during the tenure of his employment, even in the absence of an express covenant so providing." *Id.* (internal quotation marks and citations omitted).

However, the Superior Court of Massachusetts has stated that, "Contracts drafted by employers to limit the employment prospects of former employees-even those at a very high level-must be construed narrowly against the employer." *Veridiem, Inc., v. Phelan*, No. 034418BLS, 2003 WL 22481390, *3 (Mass. Super. Sept. 26, 2003).

Generally, a noncompete that is "contained in a contract for personal services will be enforced if it is reasonable, based on all the circumstances." *All Stainless, Inc. v. Colby*, 308 N.E.2d 481, 485 (Mass. 1974).

In order to determine whether to enforce a noncompete, "the reasonable needs of the former employer for protection against harmful conduct of the former employee must be weighed against both the reasonableness of the restraint imposed on the former employee and the public interest." *Id.* If the employer "has protectable and legitimate business interests, the employer's reasonable need to protect its business interests must then be weighed against the reasonableness of the restraints imposed by the noncompete covenant as well as any public interests that may be at stake." *Boch Toyota, Inc. v. Klimoski*, 18 Mass. L. Rep. 80, 2004 WL 1689770 , *4 (Mass. Super. 2004).

Courts "look less critically" at covenants "arising primarily out of the sale of a business". *Alexander & Alexander, Inc. v. Danahy*, 488 N.E.2d 22, 29 (Mass. App. 1986). However, "any covenant restricting competition is to be enforced only to the extent that it is reasonable in time and space, necessary to protect legitimate interests, and not an obstruction of the public interest." *Id.*

Reasonableness

"What is reasonable depends on the facts in each case." *Novelty Bias Binding Co. v. Shevrin*, 175 N.E.2d 374, 376 (Mass. 1961). Reasonableness of restrictions is determined

with reference to "the nature of the [employer's] business * * * the character of employment involved * * * the situation of the parties, the necessity of the restriction for the protection of the employer's business and the right of the employee to work and earn a livelihood." *Richmond Bros. Inc. v. Westinghouse Broadcasting Co.*, 256 N.E.2d 304, 307 (Mass. 1970).

A noncompete is likely to be deemed reasonable if it has a "narrow geographic scope" and a "relatively short time frame." *Boch Toyota, Inc.,* 18 Mass. L. Rptr. 80, 2004 WL 1689770 at *4 (Mass. Super., June 28, 2004) (upholding a covenant not to compete spanning a duration of twelve months and a geographic scope of thirty-five miles). Generally, a noncompete is "reasonable if its purpose is to protect an employer's legitimate business interests." *Id.* at *3.

Courts will uphold broader restrictions outside of the conventional limits of the employer-employee relationship, *e.g.*, in the context of the sale of a business. "Concern about the restricted individual and the probability of unequal bargaining power between an employer and an employee recedes when the restriction arises in the context of the sale of a business or * * * the sale of an interest in a business." *Wells v. Wells*, 400 N.E.2d 1317, 1319 (Mass. App. 1980). Therefore, courts will usually look "more critically" at the circumstances of restraints placed on employees in a post-employment context. *Id.*

In analyzing restrictions imposed as part of the sale of a business, courts "consider whether the parties entered into the agreement with the assistance of counsel and without compulsion (an element frequently not present in the employer-employee context)." *Boulanger v. Dunkin' Donuts, Inc.*, 815 N.E.2d 572, 577 (Mass. 2004) (internal citations and quotation marks omitted).

Duration

"Each time an employee's employment relationship with the employer changes materially such that they have entered into a new employment relationship a new restrictive covenant must be signed." *Lycos, Inc. v. Jackson*, 2004 WL 2341335, at *3, 18 Mass. L. Rep. 256 (Mass. Super. Aug. 25, 2004); see also *Cypress Group, Inc. v. Stride & Assocs., Inc*., 17 Mass. L. Rptr. 436, 2004 WL 616302 (Mass. Super. Feb. 11, 2004) (same). Similarly, in *F.A. Bartlett Tree Expert Co. v. Barrington*, 233 N.E.2d 756 (Mass. 1968), the Massachusetts Supreme Court voided an employment agreement containing a restrictive covenant because there were subsequent changes in the defendant's employment that changed the employment relationship. In particular, the court noted that "the defendant's rate of compensation and sales area were changed" and "[s]uch far reaching changes strongly suggest that the parties had abandoned their old arrangement and had entered into a new relationship." *Id.* at 758.

In an employment context, a five-year restriction will generally be found to be

unreasonable, whereas a three-year restriction will generally be found to be reasonable. *Richmond Bros., Inc. v. Westinghouse Broadcasting Co.*, 256 N.E.2d 304, 307 (Mass. 1970) (five-year restriction unreasonable; court refused to enforce remaining two years on a five-year non-competition agreement for a radio broadcaster where he had complied with the agreement for almost three-year period); *Wrentham Co. v. Cann*, 189 N.E.2d 559, 562 (Mass. 1963) (five-year restriction unreasonable; affirmed enforcement of non-competition agreement for three years).

However, in the context of a sale of a business, restrictions for five years or more are more likely to be upheld as reasonable. *Alexander & Alexander, Inc. v. Danahv*, 488 N.E.2d 22, 29-30 (Mass. App. 1986) (upholding customer-based covenant for five-year period; finding it was not unreasonable to include prospective customers within the ban and finding covenants were not unreasonably restrictive despite the fact they prevented individuals from "receiving" business; holding that in the context of the sale of a business, a covenant not to compete was proper where the seller received proceeds from the business); *Bonneau v. Meaney*, 178 N.E.2d 577, 579 (Mass. 1961) (enforcing 20-year non-competition agreement made in connection with sale of telephone answering service business);

Protectable Interests

Goodwill, "confidential or proprietary business information", "customer or supplier lists", *Boch Toyota, Inc.*, 2004 WL 1689770 at *3, and trade secrets, *RE/MAX of New England, Inc. v. Prestige Real Estate, Inc.*, 2014 WL 3058295, at *3 (D. Mass. July 7, 2014), are all protectable interests.

However, "skill and intelligence acquired or increased and improved through experience or through instruction received in the course of employment" are not protectible interests. *National Hearing Aid Centers, Inc. v. Ayers*, 311 N.E.2d 573, 578 (Mass. 1974).

Modification

A noncompete may be enforced in whole or in part. *All Stainless, Inc.*, 308 N.E.2d 481, 485. "If the covenant is too broad in time, in space or in any other respect, it will be enforced only to the extent that is reasonable and to the extent that it is severable for the purposes of enforcement." *Id.*

Specific Professions

Doctors—Noncompetes are void. *Falmouth Ob-Gyn Assocs., Inc. v. Abisla*, 629 N.E.2d 291, 293-94 (Mass. 1994) (noncompete was unenforceable because the Massachusetts physician non-competition statute prohibits "any restriction" on the ability of physicians to practice).

Nurses—Noncompetes are void. Mass. Gen. Laws ch. 112, § 74D (1983). That statue provides that:

> "Any contract or agreement which creates or establishes the terms of a

> partnership, employment, or any other form of professional relationship with a nurse registered to practice as a registered nurse pursuant to section seventy-four, or a practical nurse registered to practice as a licensed practical nurse pursuant to section seventy-four A, which includes any restriction of the right of such nurse to practice as a nurse in any geographical area for any period of time after the termination of such partnership, employment or professional relationship shall be void and unenforceable with respect to said restriction. Nothing in this section shall render void or unenforceable any other provision of any such contract or agreement."

Broadcasters—Noncompetes are void. Mass. Gen. Laws ch. 149, § 186 (1998). That statute provides that:

> "Any contract or agreement which creates or establishes the terms of employment for an employee or individual in the broadcasting industry, including, television stations, television networks, radio stations, radio networks, or any entities affiliated with the foregoing, and which restricts the right of such employee or individual to obtain employment in a specified geographic area for a specified period of time after termination of employment of the employee by the employer or by termination of the employment relationship by mutual agreement of the employer and the employee or by termination of the employment relationship by the expiration of the contract or agreement, shall be void and unenforceable with respect to such provision. Whoever violates the provisions of this section shall be liable for reasonable attorneys' fees and costs associated with litigation of an affected employee or individual."

Social workers—Noncompetes are void. Mass. Gen. Laws ch. 112, § 135C. That statute provides that:

> A contract or agreement creating or establishing the terms of a partnership, employment, or any other form of professional relationship with a social worker licensed under this chapter that includes a restriction of the right of the social worker to practice in any geographic area for any period of time after termination of the partnership, employment or professional relationship shall be void and unenforceable with respect to that restriction. This section shall not render void or unenforceable the remainder of the contract or agreement.

Attorneys—Noncompetes are void. *Meehan v. Shaughnessy*, 535 N.E.2d 1255, 1262 (Mass. 1989). In that case, the court explained that, ethically, "a lawyer may not participate in an agreement which restricts the right of a lawyer to practice law after the termination of a relationship created by the agreement."

The court found that this rule protects the public. *Id.*

Maine

Generally, in Maine, covenants not to compete "are contrary to public policy and will be enforced only to the extent that they are reasonable and sweep no wider than necessary to protect the business interests in issue." *Chapman & Drake v. Harrington*, 545 A.2d 645, 647 (Me. 1988) (internal citation and quotation marks omitted). The reasonableness of a noncompetition agreement "is a question of law to be determined by the court." *Id.* A party may show reasonableness by developing case-specific facts regarding the noncompete's "duration, geographic area and the interests sought to be protected." *Id.* Because Maine "law does not favor non-competition agreements * * * it requires that such agreements be construed narrowly and technically." *Id.*

Reasonableness

Chapman & Drake illustrates the way that Maine courts look at the reasonableness of noncompetition agreements. In that case, the court explained that, "There is further support for the reasonableness of a covenant not to compete when the employee limited thereby has had access to his employer's confidential information, including customer lists, and is in a position after leaving his employer to take advantage of that information." *Id.* at 647.

Although the noncompetition agreement in that case did not contain a geographical limitation, the court found that it was reasonable because it was negotiated by both parties—the employee and the employer—and it "simply" prohibited the employee from "soliciting or accepting" the employer's customers. *Id.* at 648. Therefore, the employee was not overly burdened by the noncompete and the noncompete did not violate public policy. *Id.* at 648-49.

In *Flaherty v. Libby*, 81 A. 166, 167 (Me. 1911), the court found that it is "customary and oftentimes necessary that a person purchasing the business of another, with the good will that should follow the transaction, enters into an agreement with the seller, whereby the seller is restricted from engaging in a similar business within specified districts."

However, "protecting an employer from business competition is not a legitimate business interest to be advanced by" a noncompete. *Brignull v. Albert*, 666 A.2d 82, 84 (Me. 1995).

Duration

Although the noncompete at issue in *Chapman & Drake* was for five years, the court found that the duration was not per se unreasonable because the agreement did not preclude the employee from selling insurance—it only precluded him from doing business with people who were customers of the employer at the time that the employee worked for the employer. 545 A.2d at 648. The court also found that, "As enforced, the

five-year limit also is reasonably related to protecting recognized legitimate business interests of" the employer. *Id.*

Protectable interests

The sale and protection of goodwill are interests that may be protected by noncompetes. *Flaherty*, 81 A. at 167 (sale of goodwill); *Brignull*, 666 A.2d at 84 (protection of goodwill). Trade secrets are also protectable interests. *Roy v. Bolduc*, 34 A.2d 479, 481 (Me. 1943). A "list of current patients" is a protectable business interest. *Brignull*, 666 A.2d at 84.

Modification

If a court finds that a noncompete is overbroad, the agreement may be modified and enforced to the extent reasonable. *Lord v. Lord*, 454 A.2d 830, 834 (Me. 1983). Maine courts will evaluate the reasonableness of a noncompetition clause as the employer seeks to apply it, as opposed to how it is written and may be hypothetically applied. *Brignull*, 666 A.2d at 84; *Prescott v. Ross*, 383 F.Supp.2d 180, 190 (D. Me. 2005). However, the court will not impose its own draft of an overly broad provision on the parties. *Prescott v. Ross*, 390 F.Supp.2d 44, 47 (D. Me. 2005). Instead, the party seeking to enforce the noncompete, may only rely on the court to narrow the scope of the noncompete. *Id.*

Second Circuit

Generally, noncompetition agreements "are narrowly construed by the courts" in the Second Circuit, "and must contain time, geographic and/or industry limitations". *A.N. Deringer, Inc. v. Strough*, 103 F.3d 243, 248 (2d Cir. 1996).

The Second Circuit generally disfavors noncompetes in the employment context, and enforces them only to the extent that they are reasonable and necessary to protect valid interests. *AM Media Communications Group v. Kilgallen*, 261 F.Supp.2d 258 (S.D.N.Y. 2003).

Reasonableness

In evaluating whether a noncompete is reasonable, "courts must weigh the need to protect the employer's legitimate business interests against the employee's concern regarding the possible loss of livelihood." *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 69 (2d Cir. 1999).

A ten-mile geographic restriction is reasonable. *Singas Famous Pizza Brands Corp. v. N.Y. Adver. LLC*, 468 Fed. Appx. 43, 2012 WL 89923, *3 (2d Cir. Mar. 19, 2012)

Duration

Generally short periods of time will be found reasonable. *A.N. Deringer, Inc.*, 103 F.3d at 248 (no one disputed that 90 days was reasonable).

Protectable Interests

Protectable interests include confidential information, *A.N. Deringer, Inc.*, 103 F.3d at

248; "institutional know-how, reputation, and goodwill", *Singas*, 468 Fed. Appx. 43, 2012 WL 89923 at *3; and "confidential information, such as customer lists and other confidential information not generally known to the public", *Am. Fed. Grp., Ltd. v. Rothenberg* (*American Federal Group 1*), 136 F.3d 897, 906 (2d Cir. 1998).

Modification

"Generally, a contract will not be regarded as severable unless (1) the parties' performances can be apportioned into corresponding pairs of partial performances, and (2) the parts of each pair can be treated as agreed equivalents." *Ginett v. Computer Task Group, Inc.*, 962 F.2d 1085, 1098 (2d Cir. 1992)

New York

Covenants not to compete were at one time disfavored by New York courts. *Purchasing Assocs., Inc. v. Weitz*, 196 N.E.2d 245, 247-48 (N.Y. 1963). However, noncompetes are now generally enforced under New York law as long as they are reasonable and protect legitimate business interests. *Id.* Broad noncompete agreements are likely to be viewed more favorably in the context of the sale of a business as opposed to an employee who has signed an employer-drafted noncompete. *Id.* In the context of an employee who has signed an employer-drafted noncompete, those agreements are likely to be upheld if they are narrow in scope. *Id.* "Thus, a covenant by which an employee simply agrees, as a condition of his employment, not to compete with his employer after they have severed relations is not only subject to the overriding limitation of 'reasonableness' but is enforced only to the extent necessary to prevent the employee's use or disclosure of his former employer's trade secrets, processes, or formulae * * * or his solicitation of, or disclosure of any information concerning, the other's customers * * *." *Id.* However, if "the employee's services are deemed 'special, unique or extraordinary,' then, the covenant may be enforced by injunctive relief, if 'reasonable,' even though the employment did not involve the possession of trade secrets or confidential customer lists." *Id.*

Reasonableness

Generally, "reasonable" means, "not more extensive, in terms of time and space, than is reasonably necessary" to protect legitimate business interests. *Purchasing Assocs., Inc.*, 196 N.E.2d at 247-48.

Under New York law, "The modern, prevailing common-law standard of reasonableness for employee agreements not to compete applies a three-pronged test. A restraint is reasonable only if it: (1) is *no greater* than is required for the protection of the *legitimate interest* of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public. A violation of any prong renders the covenant invalid." *BDO Seidman v. Hirshberg*, 712 N.E.2d 1220, 1223 (N.Y. 1999) (emphasis in original). Therefore, "a restrictive covenant will only be subject to specific enforcement to the extent that it is reasonable in time and area, necessary to

protect the employer's legitimate interests, not harmful to the general public and not unreasonably burdensome to the employee." *Id.* (internal quotation marks and citations omitted).

Broad restrictive covenants are not likely to be enforced. *Id.*

It is unreasonable to restrict competition in a case where the former employee gained clients with whom he did not have a relationship prior to leaving his former employer. *Id.* at 1225 (explaining that, "it would be unreasonable to extend the covenant to personal clients of defendant who came to the firm solely to avail themselves of his services and only as a result of his own independent recruitment efforts, which BDO neither subsidized nor otherwise financially supported as part of a program of client development.").

Duration

"To impose a continuing restraint beyond the period agreed upon is contrary to the agreement and not equitable." *DeLong Corp. v. Lucas*, 176 F.Supp. 104, 126 (S.D.N.Y. 1959), *aff d*, 278 F.2d 804 (2d Cir. 1960), *aff'd*, 364 U.S. 833, 81 S. Ct. 71, 5 L. Ed.2d 58 (1960).

However, in dealing with restrictive covenants between professionals, courts are not opposed to long durations, particularly when the restrictions are geographically limited or in rural areas. *BDO Seidman*, 712 N.E.2d at 1223 (explaining that the court has upheld even permanent restrictions as well as restrictions for five years in rural locations). Accountants are considered professionals in this context. *Id.* However, courts are not as likely to uphold lengthy restrictions in large metropolitan areas. *Id.* at 1224.

Protectable Interests

Protectable interests include the sale of goodwill, *Purchasing Assocs., Inc.*, 196 N.E.2d at 247-48; the employer's trade secrets or "confidential customer lists, or protection from competition by a former employee whose services are unique or extraordinary", *BDO Seidman*, 712 N.E.2d at 1223.

Customer lists are only protectable if they are trade secrets or are confidential. *Briskin v. All Seasons Servs., Inc.*, 206 A.D.2d 906, 906 (1994). However, "an employer has sufficient interest in retaining present customers to support an employee covenant where the employee's relationship with the customers is such that there is a substantial risk that the employee may be able to divert all or part of the business" *Service Systems Corp. v. Harris*, 41 A.D.2d 20, 23-24 (1973).

Modification

New York courts exercise their "judicial power to sever and grant partial enforcement for an overbroad employee restrictive covenant." *BDO Seidman*, 712 N.E.2d at 1226.

Under New York law, if the noncompete is overly broad, the court will not simply invalidate it. *Id.* Rather, when

> "the unenforceable portion is not an essential part of the agreed exchange, a court should conduct a case specific analysis, focusing on the conduct of the employer in imposing the terms of the agreement (*see*, Restatement [Second] of Contracts § 184). Under this approach, if the employer demonstrates an absence of overreaching, coercive use of dominant bargaining power, or other anti-competitive misconduct, but has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing, partial enforcement may be justified"

Id. (some internal citations omitted.)

The Ninth Circuit

As explained in further detail below, the Ninth Circuit's interpretation of a restrictive covenant or noncompetition agreement depends entirely on the state law that governs the agreement. Generally, "Covenants by an employee not to compete have never been especially favored in equity but may be enforced if not unreasonable and if not broader than required for the employer's protection. There is no reason, however, to enforce a covenant which by its terms is no longer in effect." *Econ. Lab., Inc. v. Donnolo*, 612 F.2d 405, 408 (9th Cir. 1979).

Reasonableness

Whether a noncompete is reasonable is either a question of fact or a question of law, depending upon the state law that governs the agreement. *Rent-A-Center, Inc. v. Canyon TV and Appliance Rental, Inc.*, 944 F.2d 597, 600 (9th Cir. 1991.) Once the court determines the standard of review, it will use the appropriate state's law to determine whether the agreement is reasonable. *Id.*

Protectable Interests

The court will evaluate whether the interests that the employer or the drafter of the agreement seeks to protect are actually protectable under the applicable state law. *Safelite Glass Corp. v. Crawford*, 25 Fed.Appx. 613, 2002 WL 22342, *1 (9th Cir., January 8, 2002).

Duration

The acceptable duration for a restrictive covenant or noncompetition agreement depends on the applicable state law, particularly what that state regards as reasonable in a restrictive covenant context. *Henry Hope X–Ray Prod., Inc. v. Marron Carrel, Inc.*, 674 F.2d 1336, 1342 (9th Cir. 1982).

Modification

The court will use the applicable state's law to determine the scope, if any, of modification for a restrictive covenant or noncompete. *Four Seasons Freight Services, Inc. v. Haralson*, 96 F.3d 1451, 1996 WL 506182, *1 (9th Cir., September 4, 1996).

California

California has statutes regarding restrictive covenants and noncompetes. Generally, "there exists a clear legislative declaration of public policy against covenants not to compete." *D'sa v. Playhut, Inc.*, 85 Cal. App. 4th 927, 933 (2000). For example, California's Business and Professions Code, section 16600, provides that, "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

California allows noncompetes when selling a business. Specifically, California's Business and Professions Code, section 16601, provides that:

> "Any person who sells the goodwill of a business, or any owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity, or any owner of a business entity that sells (a) all or substantially all of its operating assets together with the goodwill of the business entity, (b) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary, or (c) all of the ownership interest of any subsidiary, may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein."

Under section 16601, in order to uphold a noncompete, "The transaction must clearly establish that it falls within this limited exception. The practical effect of the transaction and the economic realities must be considered." *Hill Med. Corp. v. Wycoff*, 86 Cal. App. 4th 895, 903 (2001). Courts will evaluate whether goodwill was considered in determining the sales price "[i]n order to restrain the seller's profession, trade, or business". *Id.* In other words, there must be a showing that the buyers were entitled to protection "from competition from the seller which competition would have the effect of reducing the value of the property right that was acquired." *Id.* (internal citations and quotation marks omitted.)

Similarly, when a seller transfers all of her corporate shares and when those shares constitute only a small amount of the corporate shares, the court should evaluate the agreement according to the same factors, specifically, "did the transaction take into account corporate goodwill?" *Id.* at 903-04. The seller must have sold "the goodwill of the corporation." *Id.* at 904 (internal citation and quotation marks omitted). In other words:

> "Simply selling shares to an individual vendee or back to the corporation does not necessarily demonstrate that goodwill is part of the agreement. To

> hold otherwise, would result in the enforceability of all covenants not to compete involving the sale of all of the vendors shares, in violation of the purposes behind sections 16600 and 16601."

Wycoff, 86 Cal. App. 4th at 904.

Noncompetes are also allowed in the context of the dissolution of a partnership (Cal. Bus. & Prof. § 16602), or the sale or dissolution of a limited liability corporation (*Id.* at § 16602.5).

Attempts have been made to persuade courts to adopt "a narrow-restraint exception to section 16600", *Ret. Group v. Galante*, 176 Cal. App. 4th 1226, 1236 (2009), but courts have generally held that, "Section 16600 is unambiguous, and if the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect." *Id.* In *Galante*, the court left "it to the Legislature, if it chooses, either to relax the statutory restrictions or adopt additional exceptions to the prohibition-against-restraint rule under section 16600." *Id.*

Reasonableness

Generally, the above statutes will control the validity of a restrictive covenant. However, "time, circumstances and public policy may change the reasonable interpretation of a restrictive covenant." *Welsch v. Goswick*, 130 Cal. App. 3d 398, 405-06 (1982). For example, in *Welsch*, the court looked at "whether social, economic and legal conditions have changed such that the covenant, limiting use of subdivision lots to single-family residential purposes, would currently be interpreted to prohibit operation of a residential care facility serving six or fewer persons." *Id.* at 406.

Protectable Interests

Goodwill is protectable, as explained above. Trade secrets are also protectable. "[It is not the solicitation of the former employer's customers, but is instead the *misuse of trade secret information*, that may be enjoined. *Galante*, 176 Cal. App. 4th at 1237 (emphasis in original).

Customer lists constitute trade secrets and are protectable. *Id.* at 1238. As long as the customer lists do not contain public information that is "readily ascertainable", or easily identifiable, the lists may be protected. *Id.* (internal citations and quotation marks omitted).

Preventing disruption in the workplace is generally a protectable interest. "The restriction presumably was sought by plaintiffs in order to maintain a stable work force and enable the employer to remain in business." *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 280 (1985).

Duration

"[D]uration alone of a restrictive agreement is not determinative of its enforceability. *Id.* at 279.

Modification

"Generally, courts reform contracts only where the parties have made a mistake and not for the purpose of saving an illegal contract." *Kolani v. Gluska*, 64 Cal. App. 4th 402, 406-07 (1998) (internal citations omitted). Courts may save noncompetes by narrowly construing them, but they will do so only when the contract is not statutorily void (a court could save a noncompete if, for example, it is ancillary to the sale of goodwill and not invalid on its face). *Id.* at 407. Courts have 'blue penciled' noncompetition covenants with overbroad or omitted geographic and time restrictions to include reasonable limitations." *Strategix, Ltd. v. Infocrossing W., Inc.*, 142 Cal. App. 4th 1068, 1074 (2006).

Specific Professions

Lawyers—Lawyers generally may not be restricted from practicing. *Howard v. Babcock*, 6 Cal. 4th 409, 416 (1993). However, "An agreement that assesses a reasonable cost against a partner who chooses to compete with his or her former partners does not restrict the practice of law. Rather, it attaches an economic consequence to a departing partner's unrestricted choice to pursue a particular kind of practice." *Id.* at 419.

Accountants—Accountants may be restricted if they withdraw from a partnership and if the noncompete is limited to a small geographic area. *Id.* at 416.

Doctors—Doctors generally may not be restricted from practicing, "but a withdrawing partner may contract that if he exercises that privilege he will compensate his former partners to some extent at least for the business which he expects to take from them. *Id.* (internal citation and quotation marks omitted).

Oregon

Noncompetes in an employment context are governed by a lengthy statute, ORS 653.295, which provides that:

> "(1) A noncompetition agreement entered into between an employer and employee is voidable and may not be enforced by a court of this state unless:
> "(a)(A) The employer informs the employee in a written employment offer received by the employee at least two weeks before the first day of the employee's employment that a noncompetition agreement is required as a condition of employment; or
> "(B) The noncompetition agreement is entered into upon a subsequent bona fide advancement of the employee by the employer;
> "(b) The employee is a person described in ORS 653.020(3);
> "(c) The employer has a protectable interest. As used in this paragraph, an employer has a protectable interest when the employee:
> "(A) Has access to trade secrets, as that term is defined in ORS 646.461;

"(B) Has access to competitively sensitive confidential business or professional information that otherwise would not qualify as a trade secret, including product development plans, product launch plans, marketing strategy or sales plans; or

"(C) Is employed as an on-air talent by an employer in the business of broadcasting and the employer:

"(i) In the year preceding the termination of the employee's employment, expended resources equal to or exceeding 10 percent of the employee's annual salary to develop, improve, train or publicly promote the employee, provided that the resources expended by the employer were expended on media that the employer does not own or control; and

"(ii) Provides the employee, for the time the employee is restricted from working, the greater of compensation equal to at least 50 percent of the employee's annual gross base salary and commissions at the time of the employee's termination or 50 percent of the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination; and

"(d) The total amount of the employee's annual gross salary and commissions, calculated on an annual basis, at the time of the employee's termination exceeds the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination. This paragraph does not apply to an employee described in paragraph (c)(C) of this subsection.

"(2) The term of a noncompetition agreement may not exceed 18 months from the date of the employee's termination. The remainder of a term of a noncompetition agreement in excess of 18 months is voidable and may not be enforced by a court of this state.

"(3) Subsections (1) and (2) of this section apply only to noncompetition agreements made in the context of an employment relationship or contract and not otherwise.

"(4) Subsections (1) and (2) of this section do not apply to:

"(a) Bonus restriction agreements, which are lawful agreements that may be enforced by the courts in this state; or

"(b) A covenant not to solicit employees of the employer or solicit or transact business with customers of the employer.

"(5) Nothing in this section restricts the right of any person to protect trade secrets or other proprietary information by injunction or any other lawful means under other applicable laws.

"(6) Notwithstanding subsection (1)(b) and (d) of this section, a noncompetition agreement is enforceable for the full term of the agreement, for up to 18 months, if the employer provides the employee, for

the time the employee is restricted from working, the greater of:

"(a) Compensation equal to at least 50 percent of the employee's annual gross base salary and commissions at the time of the employee's termination; or

"(b) Fifty percent of the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination.

"(7) As used in this section:

"(a) "Bonus restriction agreement" means an agreement, written or oral, express or implied, between an employer and employee under which:

"(A) Competition by the employee with the employer is limited or restrained after termination of employment, but the restraint is limited to a period of time, a geographic area and specified activities, all of which are reasonable in relation to the services described in subparagraph (B) of this paragraph;

"(B) The services performed by the employee pursuant to the agreement include substantial involvement in management of the employer's business, personal contact with customers, knowledge of customer requirements related to the employer's business or knowledge of trade secrets or other proprietary information of the employer; and

"(C) The penalty imposed on the employee for competition against the employer is limited to forfeiture of profit sharing or other bonus compensation that has not yet been paid to the employee.

"(b) 'Broadcasting' means the activity of transmitting of any one-way electronic signal by radio waves, microwaves, wires, coaxial cables, wave guides or other conduits of communications.

"(c) 'Employee' and 'employer' have the meanings given those terms in ORS 652.310.

"(d) 'Noncompetition agreement' means an agreement, written or oral, express or implied, between an employer and employee under which the employee agrees that the employee, either alone or as an employee of another person, will not compete with the employer in providing products, processes or services that are similar to the employer's products, processes or services for a period of time or within a specified geographic area after termination of employment."

ORS 653.295 is construed broadly, and applies to non-solicitation agreements. *First Allmerica Fin. Life Ins. Co. v. Sumner*, 212 F. Supp. 2d 1235, 1238 (D. Or. 2002) (stating that, "Plaintiffs' attempt to draw a distinction between a prohibition against solicitation of former employees and a prohibition against inducing customers to terminate their relationship with the plaintiffs is misplaced given the Oregon court's broad construction of the statutory reach of ORS 653.295.").

Under ORS 653.295(1)(a), "Any non-*de minimis* delay, between the commencement of employment and when the agreement was

signed, is fatal." *Konecranes, Inc. v. Scott Sinclair*, 340 F. Supp. 2d 1126, 1129 (D. Or. 2004)

If an employee refuses to sign a noncompete and is fired, there is no claim for wrongful discharge. *Dymock v. Norwest Safety Protective Equip. for Oregon Indus., Inc.*, 45 P.3d 114, 116 (Or. 2002) (stating that, "Because ORS 653.295 does not confer on plaintiff the right to refuse to sign the agreement that is at issue in this case * * * our inquiry is at an end. Plaintiff has failed to state a claim for wrongful discharge.").

The noncompete is enforceable even if the employee is fired. *Nike, Inc. v. McCarthy*, 285 F. Supp. 2d 1242, 1246 (D. Or. 2003) *aff'd*, 379 F.3d 576 (9th Cir. 2004). In *McCarthy*, the court explained that:

> "Similarly, the fact that defendant may have been forced out of the company bears no direct relation to the validity of the contract—the severance pay package alleviates any unfairness, unconscionability or "unclean hands" in enforcing the non-compete for a 1–year period. Further, nothing in the terms of the contract invalidates its provisions based upon the voluntary or involuntary nature of defendant's separation from the company."

Id.

Choice of law is generally not an issue because Oregon courts will likely always interpret noncompetes according to Oregon law. ORS 653.295(1) (which states that a noncompete "may not be enforced by a court of this state" unless it meets the statutory requirements. Similarly, "An Oregon employer cannot circumvent Oregon laws designed to protect Oregon workers simply by decreeing that the laws of another state will apply. *Konecranes*, 340 F. Supp. 2d at 1130.

Reasonableness

"A noncompetition provision in an employment contract is a covenant in restraint of trade." *Volt Servs. Grp., Div. of Volt Mgmt. Corp. v. Adecco Employment Servs., Inc.*, 35 P.3d 329, 333 (Or. App. 2001). In order for a noncompete to be valid, three requirements must be met:

> "(1) it must be partial or restricted in its operation in respect either to time or place; (2) it must come on good consideration; and (3) it must be reasonable, that is, it should afford only a fair protection to the interests of the party in whose favor it is made, and must not be so large in its operation as to interfere with the interests of the public."

N. P. Lumber Co. v. Moore, 551 P.2d 431, 434 (Or. 1976) (*citing Eldridge et al. v. Johnston*, 245 P.2d 239, 250 (1952)).

These requirements must be met "[e]ven if the covenant not to compete is not void under section 653.295[.]" *McCarthy*, 379 F.3d at 584.

Whether a noncompete is reasonable "must be determined in view of what is reasonably necessary to safeguard the employer's protectible interest." *Volt Servs. Grp.,* 35 P.3d at 334.

A noncompete without geographic limitation is not automatically void. *Renzema v. Nichols*, 731 P.2d 1048, 1049 (Or. App. 1987). "If possible, the noncompetition clause should be interpreted so as to make the extent of its operation reasonable." *Id.* Whether the noncompete is reasonable will depend on the facts. *Id.*

Protectable Interests

Protected interests in an employment context are set out above in 653.295(1)(c).

Customer contacts and customer lists are protectable. *Volt Servs. Grp.*, 35 P.3d at 334.

"'[G]eneral knowledge, skill, or facility acquired through training or experience while working for an employer" is not protectable, even if the employee developed that knowledge during the employment period. *Rem Metals Corp. v. Logan*, 565 P.2d 1080, 1083 (Or. 1977) (internal citation and quotation marks omitted). This is true "even though the on-the-job training has been extensive and costly." *Id.* (internal citation and quotation marks omitted). Rather, the purpose of a noncompete "to prevent competitive use, for a time, of information or relationships which pertain peculiarly to the employer and which the employee acquired in the course of the employment." *Id.* (internal citation and quotation marks omitted). The employer has the burden of proof "to establish the existence of 'trade secrets,' 'information or relationships which pertain peculiarly to the employer,' or other 'special circumstances' sufficient to justify the enforcement of such a restrictive covenant." *Id.*

Duration

As explained above, in the employment context, "The term of a noncompetition agreement may not exceed 18 months from the date of the employee's termination." ORS 653.295(2)

90 days is reasonable. *Volt Servs. Grp.*, 35 P.3d at 334-35.

If the noncompete is not excessive in regard to geographic limitation, an agreement without a time limit will not be deemed void on its face. *Kelite Prods. v. Brandt*, 294 P.2d 320, 328 (Or. 1956). "In cases where no limitation of time is provided by the contract, a reasonable time will be implied, and what is reasonable time will depend upon all the facts and circumstances of the case." *Id.*

Modification

As explained above, if there is no time or geographic limitation, a reasonable time or geographic limitation will be implied. *Kelite Prods.*, 294 P.2d at 328; *Renzema*, 731 P.2d at 1049. What is reasonable depends on the facts and circumstances of each case. *Id.*

Using Bankruptcy as a Sword Rather than a Shield: Protecting Intellectual Property Rights When a Licensor Files Bankruptcy

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Intellectual Property ("IP") is vital to the success of many domestic and international companies. Companies now heavily rely on patents, trade secrets, etc., to fulfill their business objectives. They spend millions of dollars and a great deal of manpower to research, manufacture, improve, and commercialize products that result from this IP. Many of these companies did not develop the intellectual property themselves but rely on licenses to use the IP. Due to the high stakes, licensees need to know whether it is safe to enter a licensing agreement with a party that is not financially secure. Can a licensee's rights to IP be terminated if the licensor files bankruptcy?

Executory Contract. An executory contract is "A contract that remains wholly unperformed or for which there remains something still to be done on both sides, [or] often as a component of a larger transaction..."[1] Licenses for the use of intellectual property are typically considered executory contracts seeing as they are often part of a larger contract between two parties. The Bankruptcy Code allows companies that file bankruptcy to reject existing executory contracts to eliminate any financial obligations and allow the company to "wipe the slate clean."[2] This, in turn, allows a licensor that files for bankruptcy to reject an intellectual property licensing agreement. For companies depending on IP licenses for the development and manufacturing of a product this is a daunting notion.

Bankruptcy Code § 365(n). In *Lubrizol* the court held that when a licensor rejects an intellectual property license, they deprive the licensee of the right to continue use of the intellectual property that was originally granted under the license.[3] This result was troubling because the only remedy remaining, monetary damages, would not replace the loss of a unique technology around which the licensee created its business.[4] Congress was concerned that scientists and technologists would react to this ruling by contracting for full assignment of intellectual property rights rather than forming a licensing arrangement that was at risk of dissolving in the event of bankruptcy.[5] This type of a response would threaten the development of intellectual property, the resulting products, and the formation of new businesses. In response to this ruling and the potential fall out, the legislature added § 365(n) to the Bankruptcy Code. The purpose of this section was "to make clear that the rights of an intellectual property licensee to use the licensed property cannot be unilaterally cut off as a result of the rejection of the license pursuant to Section 365 in the event of the licensor's bankruptcy."[6] § 365(n) provides that in the event a licensor files for bankruptcy, the licensee has the right to either treat the executory contract as terminated or to retain its rights under the executory contract to such intellectual property as existed immediately prior to the case for (1) the duration of the original contract or (2) any extended period for which the original contract and law allows.[7] Companies who built their business around an IP licensing agreement are now afforded protection if the licensor files bankruptcy. What a sigh of relief.

Notable Limitations and Important Issues. The first major limitation of §365(n) is that if the executory contract is rejected, the license is also rejected and the licensor no longer has to perform under the license. The licensor does not have to provide the licensee with information about updates, developments, or

[1] BLACK'S LAW DICTIONARY 144 (Bryan A. Garner 3rd ed. 1996). *In re Columbia Gas Sys. Inc*. 50 F.3d 233, 238 (3rd Cir. 1995).
[2] 11 U.S.C. § 365(a).
[3] *Lubrizol Enters., Inc. v. Richmond Metal Fisnishers, Inc.,* 756 F.2d 1043, 1048 (4th Cir. 1985).
[4] *See* S. Rep. No. 100-505, 100th Cong. 2d Sess. (1988), reprinted in 1988 U.S.C.C.A.N 3201-3202.
[5] *Id.* at 3202.
[6] *Id.* at 3200.
[7] 11 U.S.C. § 365(n)(B)(i)-(ii).

improvements to the IP. Both parties can treat the license as fully terminated.[8] The second major limitation of § 365(n) is that it does not explicitly apply to trademarks. Trademarks are not included in the Bankruptcy Code's definition of intellectual property; therefore, many courts do not extend the protection of § 365(n) to trademarks.[9] The Bankruptcy Code defines intellectual property as "trade secrets, inventions, processes, designs, plants protected under title 35, patent applications, plant varieties, works of authorship protected under title 17, or mask work protected under chapter 9 of title 17."[10] The problem with § 365(n) not explicitly protecting trademarks is that trademarks are often so closely tied with other intellectual property that the value of the remaining IP is significantly reduced without the trademark (e.g. Nike shoes without the Nike swoosh). Not extending the protection of §365(n) to trademarks also potentially allows licensors to use bankruptcy as a way to void trademark licenses. In *Exide*, Exide licensed their battery patents and "Exide" trademark to EnerSys.[11] Ten years later, Exide wanted to reenter the battery industry; however, at that time EnerSys was very successfully selling batteries with the "Exide" name (per their agreement 10 years prior).[12] EnerSys agreed to the early termination of the non-compete contract that was established when Exide left the battery industry.[13] Exide could manufacture batteries but there was one major problem. They had to sell their "Exide" batteries alongside the already successful "Exide" batteries manufactured by EnerSys.[14] Exide then filed for bankruptcy and attempted to use their bankruptcy to take its trademark back from EnerSys.[15] Since trademarks are not explicitly protected under §365(n), the Bankruptcy Court ruled in favor of Exide, finding that EnerSys did not have the right to use the "Exide" trademark.[16] The District Court affirmed the Bankruptcy Court ruling.[17] EnerSys appealed.[18] The appellate court vacated the judgment and remanded to Bankruptcy Court.[19] In Justice Ambro's concurrence, he argues, "11 U.S.C. §365 does not necessarily deprive the trademark licensee of its rights in the licensed mark."[20] Ambro believes courts should look at how § 365(n) applies to trademarks on a factual basis and use their equitable powers to provide licensors the ability to start fresh without "stripping [licensees of their] fairly procured trademark rights."[21] By allowing licensors to file bankruptcy in order to take back trademark rights that they previous bargained away, it "makes bankruptcy more a sword than a shield."[22] Although Justice Ambro highlighted a major concern with courts not allowing §365(n) to also protect trademarks, courts continue to deny licensees the right to

[8] 11 U.S.C. § 365(n)(1)(A).
[9] 11 U.S.C. § 101(35A).
[10] *Id.*
[11] *In re Exide Techs.* 607 F.3d 957 (3rd Cir. 2010).
[12] *Id.*
[13] *Id.*
[14] *Id.* at 961.
[15] *Id.*
[16] *Id. at* 250.
[17] *Id.* at 961.
[18] *Id.*
[19] *Id.* at 964.
[20] *Id.* at 965.
[21] *Id.* at 967.
[22] *Id.* at 967-8.

use trademarks when a licensor files bankruptcy. In *Tempnology*, the court construed §365(n) narrowly, wholly excluding protection for trademarks. [23] The court further refined the application of §365(n) to also exclude exclusive distribution rights associated with the intellectual property rights.[24] The court found that extending §365(n) to include distribution rights would be "far beyond its stated purpose of protecting the licensee that builds its business around licensed intellectual property to which there is no substitute." [25] The potential fall out from *Tempnology* mimics that which Justice Ambro discusses in *Exide*. Companies can potentially use bankruptcy to regain distribution rights that were previously fairly bargained away to a licensee. Although §365(n) sets out to protect licensees from losing intellectual property rights if their licensor files bankruptcy, risks to the licensee still remain.

[23] *In re Tempnology*, LLC 541 B.R. 1, 8 (Bankr. N.H. 2015).

[24] *Id.* at 6.

[25] *Id.* at 7.

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