A TAILORED APPROACH TO ENFORCING RESTRICTIVE COVENANTS

By Troy H. Ellis, Brett E. Coburn and Kandis Wood Jackson
Imagine the following scenario: You are an employer who requires your employees to execute restrictive covenant agreements containing reasonable non-competition, non-solicitation and non-disclosure provisions in order to protect your business’s proprietary interests. Since your company is headquartered in a state in the United States that typically enforces reasonable restrictive covenants, you have included a provision that the agreement will be interpreted under the laws of that state, as well as a provision through which the employee agrees that all disputes arising under the agreement must be litigated only in the company’s home state, and that he or she consents to the personal jurisdiction of the courts of that state.
You learn that one of your employees who works in California — where, by statute, non-competition agreements are generally void — is resigning to go work for a direct competitor, in violation of his restrictive covenant obligations. Before he begins working for the competitor, you sue him in a state court in your company’s state, seeking a temporary restraining order (TRO) to prevent him from going to work for the competitor. The court, honoring the choice-of-law provision and the employee’s consent to personal jurisdiction, enforces the non-competition covenant and issues a TRO enjoining the individual from working for your competitor. At this point, you have seemingly achieved your immediate objective, and you hope that this preliminary victory will drive a final resolution that keeps the employee from working for the competitor at least for the time period specified in the covenant. But, the former employee begins working for the competitor in California anyway, in direct violation of the TRO.

What can you do to enforce the TRO now? How can you protect your company’s business interests? You might guess that the US Constitution’s Full Faith and Credit Clause would help you out in these circumstances. After all, a court in your company’s home state has issued a TRO based on a preliminary finding that your contract is valid and enforceable. Doesn’t full faith and credit (FFC) require the courts of other states to enforce this order and prevent the former employee from violating the TRO and his contractual obligations? Unfortunately, the answer could very well be “no,” and in fact, there may not be a comprehensive solution to your problem at all.

**Full faith and credit is narrower than you think**

Article IV of the US Constitution instructs each state’s courts to enforce the judgments of every other state’s court under the doctrine of FFC, even when the enforcing state finds the judgment offensive to its local law or public policy. Based on this seemingly clear principle, it would be reasonable to assume that any state court order may be enforced through the courts of every other state. But, for the purposes of enforcing restrictive covenants in other states through injunctive relief, two issues regarding FFC remain unclear: (1) whether the doctrine applies to equitable decrees (i.e., state court orders intended to remedy a claim by ordering parties to act or refrain from acting in a specific way), and if so, whether it ever applies to temporary equitable decrees; and (2) whether there is a so-called public policy exception to FFC.

**Full faith and credit and equitable orders**

Typically, employers seeking to enforce restrictive covenants do so by asking a court to issue an order requiring current or former employees to refrain from violating the covenants. Unlike money judgments that require a party to pay damages, equitable orders provide a remedy to an aggrieved party through the court-mandated performance or non-performance of a certain act. For example, a TRO enjoining a former employee from working for a competitor is an equitable decree intended to prevent or remedy the violation of a restrictive covenant. In many circumstances, if an employer successfully obtains such a TRO against a former employee, and the employee nevertheless starts working for a competitor in the same state, the court can hold the employee in contempt for violating its order and can meaningfully impose sanctions, including jail time. But it is less clear whether or how a court in a different state would enforce the first court’s TRO if, for example, the employee begins working for a competitor outside of the state in which the TRO was issued.

It is well established that FFC applies to state court judgments, but it is unclear whether the doctrine requires state courts to enforce the equitable orders of other states. While the Supreme Court “has never placed equity decrees outside the FFC domain,” it has noted that “orders commanding action or inaction have been [properly] denied enforcement in a sister State.” This language suggests, unlike the “exacting” FFC obligation requiring the recognition of state court judgments “throughout the land,” the states’ obligation to enforce one another’s equitable orders is less demanding. Because the Supreme Court has yet to expressly define the scope of a state’s obligation to apply FFC to another state’s equitable decrees, one state’s...
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TRO enjoining the violation of a restrictive covenant might not be entitled to FFC in the court of another state. Extraterritorial enforcement of restrictive covenants through equitable remedies presents a second issue — one related to the type of equitable remedies employers typically seek in this context. Equitable orders, such as TROs and preliminary injunctions, are intended to provide immediate, temporary relief to an aggrieved party. On the other hand, permanent equitable orders, such as permanent injunctions, are typically only issued after a determination on the merits of a claim as part of a court’s final judgment. Employers and employees embroiled in covenant disputes often pursue immediate, temporary injunctive relief. For example, an employer whose employee quits with the intention of working for a competitor will likely ask a court to issue a TRO or preliminary injunction to stop the employee from working for the competitor well before the court actually conducts a trial on the merits of the employer’s claims. In such a scenario, the employer would be asking the court for a preliminary remedy (“Stop him now!”) rather than a final ruling (“We’ve concluded that this is a breach of covenant”).

Generally, temporary and permanent equitable orders are treated differently for FFC purposes, because the two types of orders typically affect the claims and rights of the parties to a lawsuit in different ways. While temporary orders provide immediate relief to a party, they normally do not resolve the merits of a claim or end the litigation. Permanent orders, on the other hand, have the ability to dispose of the parties’ claims and rights, ending the litigation altogether. This distinction between the effect of temporary and permanent injunctions can be an important factor in the analysis of whether FFC applies to equitable orders, and state courts have distinguished between the FFC due to dispositive, permanent orders from that due to temporary, inconclusive orders, often finding that these latter orders are not entitled to out-of-state enforcement through FFC.

For example, in *Olivares v. Performance Contracting Group*, the Michigan Court of Appeals affirmed that a Michigan trial court could give FFC to an equitable order issued in Indiana. The *Olivares* court found that even though the Indiana order was technically issued as a “preliminary injunction,” it was “dispositive of the claims and rights of the parties.” As such, the preliminary injunction operated more like a permanent injunction and, accordingly, it was entitled to FFC by a Michigan court.

Similarly, in *Marie Callender Pie Shops, Inc. v. Bumbleberry Enterprises, Inc.*,
an Oregon court held that a California permanent injunction enjoining the defendant from using the plaintiff’s trade secrets was entitled to FFC in Oregon.6 Because the California injunction set forth “the duty of the defendant and the rights of the plaintiff,” it was entitled to FFC in Oregon.7 On the other hand, a Kansas court held in Padron v. Lopez that a temporary injunction issued by a Florida court was not entitled to FFC in Kansas because the Florida equitable order was “inconclusive.”8 Thus, the Padron court refused to enforce the Florida temporary injunction because doing so would “allow a prejudgment remedy based on a nonfinal judgment.”9

Therefore, given the lingering uncertainty regarding when equitable orders are entitled to FFC, as well as the even greater hurdles associated with obtaining FFC for preliminary equitable orders, obtaining a TRO or preliminary injunction enforcing restrictive covenants may be of limited or no real value to an employer if the enjoined employee is outside of the issuing state and refuses to comply.

A so-called public policy exception to full faith and credit?

Extraterritorial enforcement of employment-related restrictive covenants may also be limited by the so-called public policy exception to FFC to which the US Supreme Court alluded in Baker. There, the Supreme Court held that a permanent injunction issued by one state’s court was not entitled to FFC in another state’s court. Baker involved two lawsuits against General Motors Corporation (GM): (i) an action brought in a Michigan court by a former GM employee named Ronald Elwell; and (ii) a wrongful death action brought in a Missouri court related to an automobile accident involving a GM vehicle. The Michigan action concluded with the issuance of a permanent injunction against Elwell, enjoining him from testifying in any future litigation involving the GM products at issue in the case. The plaintiffs in the Missouri wrongful death action, however, attempted to call Elwell as a witness in their trial. GM objected to Elwell’s appearance as a trial witness on the ground that the Michigan injunction barred his testimony pursuant to FFC. The issue made its way to the Supreme Court, which held that under the particular circumstances of the case, the Michigan court was not required to abide by the Michigan court’s permanent injunction. Notably, the Supreme Court did not address the fact that the Michigan injunction was a final order. The Baker Court recognized that “[o]rders commanding action or inaction have been denied enforcement in a sister state when they purported to accomplish an official act within the exclusive province of that other state.”10 Even though the Supreme Court noted that there is “no roving ‘public policy exception’ to the FFC due judgments,” its opinion suggests that there may be a public policy exception to the FFC given to equitable orders. Courts generally — and the Supreme Court specifically — have not definitively determined the extent to which this potentially critical exception to the FFC doctrine impacts enforcement of out-of-state equitable decrees.

Even absent definitive answers, though, the Supreme Court’s explanation in Baker suggests that a state court’s remedial orders — permanent or not — are not necessarily required to be enforced in every other state pursuant to FFC. The notion that a TRO or preliminary injunction issued by a court in one state may be viewed as an act “within the exclusive province” of another state has particular importance where restrictive covenants are involved, because states sometimes have wildly divergent public policies regarding the enforcement of restrictive covenants. For example, California statute declares non-competition and customer non-solicitation provisions void, and California has a strong public policy against the enforcement of restrictive covenants in the employment context.11 In contrast, Florida statute expresses a strong public policy in favor of enforcing restrictive covenants, and Florida courts frequently enforce reasonable covenants.12 Because of the markedly different state public policy views regarding restrictive covenants, equitable orders by a court in one state enforcing such covenants against an individual in another state are particularly susceptible to an argument that FFC should not apply when the employer seeks to expand enforcement of the court’s order beyond the issuing state’s borders.

State courts have acknowledged a so-called “public policy exception” to FFC in other contexts. For example, a Tennessee court recently recognized a public policy exception to the doctrine as applied to the right to possess a firearm.13 In Haslam, the Tennessee court acknowledged that, under the public policy exception to FFC, Tennessee courts are not obligated to give such credit to any judgment of a state that they hold to violate Tennessee’s public policy. On that basis, the Haslam

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court denied FFC to a Tennessee resident seeking the right to possess a firearm in Tennessee after he was pardoned of a felony drug conviction in Georgia and, correspondingly, restored his right to possess a firearm in Georgia because Tennessee public policy proscribes the restoration of firearm rights for convicted violent drug felons. Similarly, several California courts recognized a limited public policy exception to FFC before the Supreme Court's decision in Baker, stating that the exception arises "only when there is a violation of some fundamental state public policy." However, other state courts recognize no such exception.

The application of a similar "public policy exception" to FFC in the restrictive covenant arena could create enforcement headaches, as courts in states like California could invoke the exception to refuse to enforce equitable orders intended to uphold restrictive covenants. Without definitive answers from the Supreme Court regarding the scope of FFC in this context, the probability that a state court's covenant-related equitable order will be enforced in another state may depend, as a practical matter, on how closely that other state's public policy regarding restrictive covenants aligns with the public policy of the state in which the order was issued.

One potential way to avoid the so-called "public policy exception" to a state's FFC obligations is to seek out-of-state enforcement of an equitable order enforcing a restrictive covenant in a federal court pursuant to the federal FFC statute, 28 U.S.C. § 1738. That statute requires federal courts to give the same preclusive effect to state court judgments that those judgments would be given in the courts of the state from which they were issued. In other words, under the statute, a federal court must treat a state court's judgment the same way that a state court in the issuing state would treat it. Of course, enforcement in federal court requires federal jurisdiction, which can sometimes be difficult to establish in a case that primarily seeks injunctive relief on the basis of a state law cause of action. And the federal FFC statute is only as useful as the preclusion law of the issuing state, which, as discussed above, may very well not give preclusive effect to preliminary orders.

Practical considerations regarding extraterritorial covenant enforcement

Although there is no perfect solution to the fact that, at the end of the day, FFC is, at best, an unreliable way to enforce injunctive relief issued by courts in another state, below is a list of practical issues and strategies for employers to consider at various stages in the covenant drafting and enforcement process:

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Top [Three] Considerations for Non-compete Clauses in Europe

By Stephan C. Swinkels, executive director, L&E Global

Non-compete clauses are an essential part of any contemporary employment contract. When conducting business in foreign jurisdictions, it is imperative that you understand and are aware of current employment laws concerning the implementation and use of non-competes. Below are three points you should consider when executing a non-compete in The Netherlands, Belgium, Spain, Germany, France and Italy.

1. FORM OF THE NON-COMPETE CLAUSES

   The Netherlands: The non-compete clause has to be concluded in writing. The activities which an employee is prohibited from must be described as clearly as possible.

   Belgium: The non-compete clause must, under penalty of nullity, be established in writing. It has to be drawn up for every employee individually (but not necessarily at the moment of the conclusion of the employment contract).

   Spain: It is essential that non-compete clauses are expressly agreed, but it is not required to conclude them in writing. However, writing form could make it easier to prove its existence, as well as the conditions agreed.

   Germany: The non-compete clause must be in writing in order to be valid. The scope of non-compete should be described in detail if possible.

   France: Non-competition clause must be in writing and must be explicitly approved by the employee. If the non-competition clause is governed by the provisions of the collective bargaining agreement, the employer shall secure the proof that the employee was aware of its content, in writing.

   Italy: Non-competition clause must be in writing and must be explicitly approved by the employee.

2. BE AWARE OF THE AGE AND STATUS OF THE EMPLOYEE

   The Netherlands: The non-compete clause has to be concluded with an employee who is of age (at least 18 years old).

   Belgium: There are no restrictions regarding age.

   Spain: The non-compete clause has to be concluded with an employee who is legal of age to work (at least 16 years or older).

   Germany: The non-compete clause may be agreed with both employees and non-employees (in particular managing directors). Certain differences apply with respect to non-employees.

   France: There are no limitations concerning age and status of the employees.

   Italy: There are no limitations concerning age and status of the employees, with the sole exception of the maximum duration, which is equal to three years for employees and five years for executives.

3. NON-COMPETES MUST BE LIMITED IN TIME, AREA OR REGION

   The Netherlands: The prohibition must be limited to a certain period of time (e.g. one year). The non-compete clause must also define the territory within which the employee is prohibited from carrying out those activities.

   Belgium: The non-compete clause must contain the conditions of validity such as: similar activities, limitation as to the territory (the territory of Belgium is considered to be the largest possible geographic area where in a general non-competition clause is valid), limitation in time (the non-compete restriction is not to exceed 12 months after termination of the employment relationship) and the payment of a compensatory indemnity.

   Spain: (1) Geographical: the non-compete agreement should be limited to a particular territory; a very broad scope could be considered invalid by the Courts. (2) Functional: the prohibition should be referred to the performance of similar duties as those carried out in the former company, and related to a similar professional sector. (3) Temporary: the maximum duration is two years for top managers and technical employees (those with business technique knowledge) and six months for other employees.

   Germany: The prohibition cannot be extended beyond a period of two years following the end of the employment relationship. The territorial scope has to be justified by legitimate interest of the company.

   France: According to case law, the non-compete clause must be essential to the protection of the company’s interests, shall be limited in terms of time, territory, activity and shall provide for a financial compensation of the employee during its whole term. The principles set forth by case shall apply unless the applicable collective bargaining agreement provides other specific limitations.

   Italy: According to art.2125 of the Civil Code, non-competition clause must also be limited in terms of time, territory, and subject (i.e., activity prohibited to the employee). Limitations by territory and subject matter should not effectively prevent the employee from working at all during the duration of the obligation not to compete.

This article was originally published in 2011 as a Top Ten resource. Please visit www.acc.com/topten/non-compete-eur_jun11 for the complete version.
• If possible, avoid one-size-fits-all covenants that depend on forum selection provisions for their enforceability. While more expensive on the front end, it is generally better to tailor agreements to the particular states in which employees work and where enforcement will be more meaningful.

• When drafting covenants, strike the right balance for your company between deterrence (i.e., imposing onerous covenants with the goal of scaring employees into compliance) and maximizing the chances of meaningful enforcement (i.e., limiting the territory to the home state and surrounding states). Both objectives can have value, and where the line is appropriately drawn will depend on a number of factors, including the states where the company has employees, the company’s actual appetite for covenant enforcement litigation, and concerns about the message sent to the company’s workforce when the company chooses not to seek to enforce covenants against departing employees.

• Consider including a thoughtfully drafted liquidated damages provision in restrictive covenant agreements. Such provisions may not be desirable in all situations because: (i) of their impact on the company’s ability to recover for actual damages incurred; and (ii) they essentially offer the departing employee a known price to pay if he chooses not to comply with the covenants. They can, however, minimize the need to prove actual damages in detail, which is frequently a challenge for employers in covenant litigation. By facilitating recovery of damages, which can more readily be reduced to a final judgment that will likely be entitled to FFC, liquidated damages provisions can assist with enforcement of covenants across state borders.

• Consider whether to involve the former employee’s new employer in the covenant enforcement litigation. While this decision will be driven by a number of procedural and strategic considerations, making the new employer a party to the enforcement action may provide additional avenues for enforcing preliminary injunctive relief issued by the court in the forum state. If the new employer does business in the forum state, the court will have more options for enforcing its order, at least against the company. Additionally, the new employer may be more averse to acting in violation of a court order than the individual employee.

• Think strategically about whether to file for injunctive relief in state or federal court. While plaintiffs instituting enforcement actions frequently file in state court, there may be benefits to filing in federal court if federal jurisdiction exists. The interplay between federal and state courts can be complex, particularly where preliminary injunctive relief is sought and the possibility of competing lawsuits is very real. But obtaining injunctive relief from an out-of-state federal court may present some enforcement opportunities that may not exist with a similar state court order.

• When faced with a former employee acting in defiance of a court order, think creatively about what sanctions may be available from the court that issued the TRO. For example, while the threat of jail time as a contempt sanction may not be meaningful to an out-of-state individual, it may be possible for the court to impose substantial monetary sanctions that could quickly be reduced to a final judgment and then enforced against the former employee in his home state.

• Be thoughtful about non-legal ways to use the temporary injunctive relief against the former employee and the new employer, such as sharing the court order with customers or other relevant players. Of course, such strategies require care and legal counsel, as they are fraught with the risk of drawing defamation or tortious interference claims, as well as the potential for customer backlash.

Conclusion

The precise extent to which FFC applies to equitable decrees is yet to be defined fully by the courts, especially in the context of the out-of-state enforcement of restrictive covenants through temporary injunctive relief. This uncertainty is compounded by significant variability of state law and public policy regarding restrictive covenants. Thus, employers seeking to enforce restrictive covenants across state lines to protect their interests cannot rely exclusively on FFC to do so. Instead, they must be thoughtful and strategic during the covenant drafting and enforcement phases, and be cognizant of FFC’s uncertain parameters and limitations.

NOTES

2 Baker, 522 U.S. at 234.
4 Id. at *5.
5 Id.
7 Id.
8 289 Kan. 1089, 1102 (Kan. 2009).
9 Id.
10 Baker, 522 U.S. at 235.
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