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Measuring Midstream Noncompetes In Midwestern Courts

Law360, New York (June 11, 2015, 11:02 AM EDT) -- The Wisconsin Supreme Court recently brought much-needed clarity to Wisconsin employers and helpful guidance for other jurisdictions in ruling that continued at-will employment constitutes legal consideration to support a noncompete entered into during the course of employment. Runzheimer International Ltd. v. Friedlen, 2015 WI 45 (April 30, 2015).

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In addressing the question of consideration for a midstream noncompete, the Wisconsin Supreme Court held that "an employer's forbearance in exercising its right to terminate an at-will employee constitutes lawful consideration for a restrictive covenant." Id. at ¶59.

The decision by the Wisconsin Supreme Court is part of a growing trend among courts focusing on whether continued employment alone constitutes adequate consideration for competition restrictions. The issue has received significant attention in neighboring Illinois, where recent state court decisions have created a bright-line rule requiring two years of continued employment for adequate consideration and been met with criticism by employers.

Midstream Noncompete: Sign or Be Terminated

Friedlen was an at-will employee who had worked for Runzheimer in a business development capacity for 16 years when his employer required all employees to sign a noncompete under threat of termination. Runzheimer provided its employees two weeks to review the noncompete, at the end of which time their employment would be terminated if they did not sign the agreement. Runzheimer offered no new or additional consideration other than continued employment. Friedlen signed the agreement, which prohibited him for a period of two years following termination from working for a competitor, soliciting specified customers and using or disclosing Runzheimer's confidential information.

Friedlen was involuntarily terminated 29 months after he signed the noncompete, and soon thereafter, started a job at a competitor. Runzheimer responded by filing a lawsuit against Friedlen for breach of the noncompete. The Wisconsin Circuit Court for Milwaukee County dismissed the lawsuit on the basis that "Runzheimer made an illusory promise of continued employment to Friedlen" and that "such a promise cannot constitute consideration for the agreement." Id. at ¶15.

On appeal, and noting the lack of clarity and conflicting Wisconsin case law, the Wisconsin appellate court certified the case for review by the Wisconsin Supreme Court on the issue of whether "consideration in addition to continued employment [is] required to support a covenant not to compete entered into by an existing at-will employee." Id. at ¶17.

Wisconsin Supreme Court Ruling

As an initial matter, the Wisconsin Supreme Court confirmed, under state law, an employer's requirement that an at-will employee sign a competition agreement at the outset of employment constitutes lawful consideration. It then proceeded to address the issue of whether the offer of continued employment to an existing at-will employee (i.e., a midstream noncompete) was an illusory promise.

The Wisconsin Supreme Court held that the promise not to fire Friedlen if he signed the agreement was not illusory because it did not implicate any future conduct by the employer, rather it was simply a promise not to fire Friedlen at that time and for that reason. Further, the state high court held that "Runzheimer performed immediately when it forbore its legal right to fire Friedlen at that time." Id. at ¶46.

The Wisconsin Supreme Court was not persuaded that the promise of continued employment was illusory consideration because Runzheimer could have terminated Friedlen at any time in the future given Friedlen's at-will status. More specifically, the Wisconsin Supreme Court held that the question of whether consideration exists is determined only as of the time the contract is formed. It further stated that in the event an employer induces an existing employee to sign a competition agreement and then turns around and terminates the employee a short time later, the employee could argue for rescission of the contract on the grounds it was fraudulently induced or that the duty of good faith and fair dealing had been breached. The Wisconsin Supreme Court concluded that terminating an employee minutes after he or she signs a competition agreement "violates the spirit of the agreement," but offered no guidance on how long an employee would have to remain employed for the employer to avoid these contract defenses — leaving it to a case-by-case and fact-specific assessment.

The Wisconsin Supreme Court's approach in not requiring continued employment to last for a set period of time may well be intended to avoid the legal challenges seen in Illinois following the recent judicially created bright-line rule requiring two years of continued employment. The bright-line rule has resulted in a split of authority in the Illinois federal courts. The Seventh Circuit heard oral arguments on May 22, 2015, in the appeal of Instant Technology LLC v. Defazio, 2014 U.S. Dist. LEXIS 61232 (N.D. Ill. May 2, 2014), to address the split and whether the requirement of two years of continued employment represents the law in Illinois.

Lessons for Employers

Employers should note the following implications of this recent decision:

- Employers seeking to enforce competition restrictions under Wisconsin law will find substantial support from this decision for the enforcement of competition agreements entered into with existing employees where the only consideration being offered is continued at-will employment.

- The Wisconsin Supreme Court continues a trend in gradually softening a long history of strict scrutiny of competition agreements by Wisconsin courts. The Runzheimer decision follows Wisconsin court decisions reducing employer burdens on severability

of overbroad provisions and the scope of customer restrictions. In addition, recently proposed legislation in Wisconsin would completely reform the state's notoriously strict noncompete statute, by codifying the holding that continued employment is sufficient consideration for midstream noncompetes and by requiring courts to reform or blue-pencil overbroad restrictions. Such proposed legislation bears close monitoring by employers.

- The Wisconsin Supreme Court did not set forth a bright-line rule for consideration in stark contrast to Illinois, which requires two years of continued employment. This will benefit employers arguing that there is sufficient consideration for a midstream noncompete. Employers can avoid the debate altogether if they provide some other tangible consideration in addition to continued employment.

- The case does not impact competition restrictions entered into at the outset of employment. The Wisconsin Supreme Court confirmed that agreements entered into at the start of employment are supported by adequate consideration based on the offer of employment alone. Again, this rule stands in contrast to the present law in Illinois which requires two years of continued employment, even for competition restrictions signed at the beginning of employment.

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