

Non-Compete Agreements Enforceable against Two Former Executives, Tennessee Court Rules

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Practices

Litigation
Restrictive Covenants, Trade
Secrets and Unfair Competition

Non-compete agreements are enforceable against former employees, according to Tennessee law, as long as the agreements are reasonable and necessary to protect the employer's legitimate interests, the Court of Appeals of Tennessee has ruled. *James F. Dill Jr. et al. v. Continental Car Club, Inc. et al.*, No. E2013-00170-COA-R3-CV (Tenn. Ct. App. Oct. 31, 2013). While the Tennessee court held the agreements restricting two former executives from competing throughout the United States against their former employer were enforceable, it declined to enforce the Florida choice-of-law provision in the agreements, finding the provision incompatible with Tennessee's public policy. Such a provision identifies the state's law which will apply if any dispute arises over the interpretation of an agreement.

Facts

Two executives of Continental Car Club, Inc., a corporation based in Dayton, Tennessee, entered into employment agreements when the company for which they worked was acquired by Fortegra Financial Corporation in 2010. Under these contracts, the executives agreed they would not compete with the company anywhere in the United States where it conducted business for two years following their respective terminations of employment. The agreements further provided that the contracts would "be construed under and enforced in accordance with the internal laws of the State of Florida."

The executives resigned on July 27, 2011. On August 18, 2011, they filed a complaint against Continental and Fortegra, alleging fraudulent inducement, misrepresentation, breach of contract, and breach of the implied duty of good faith and fair dealing. They requested injunctive relief and asked the trial court to declare that they were entitled to full severance pay under their employment contracts, and that the non-compete provisions were void and unenforceable. Fortegra filed a counterclaim alleging breach of the employment agreements, conversion (i.e., depriving an owner of personal property without authorization or consent), and violation of the Tennessee or Florida Uniform Trade Secrets Act.

Following a hearing, the trial court denied the executives' request for temporary injunctive relief and ruled that Florida law was applicable under their agreements. After a bench trial, the trial court determined that the covenants not to compete were valid and enforceable and that the agreements were reasonable in their durational and geographical constraints, but partially overbroad in scope.

Choice-of-Law Rejected

On review, the Court of Appeals of Tennessee concluded that Florida statutory law contravened Tennessee's public policy as it pertained to these disputes, and therefore could not be enforced. It held that Florida law does not prefer construction of an agreement restricting employment in favor of the former employee and does not permit consideration of the imposition of any hardship on the departing employee, as Tennessee law instructs. Accordingly, the Court rejected the Florida choice-of-law provision and applied Tennessee law to its interpretation of the non-compete provisions.

The Court concluded Fortegra, which had given the executives access to its trade and business secrets and other confidential information, and whose new subsidiary's customers associated the executives with Continental, had a legitimate business interest that was protectable by the agreements. Moreover, the agreements were viewed as essential to the sale of Continental, including its goodwill, to Fortegra.

However, the scope of the non-competition restrictions, which covered Fortegra *and its subsidiaries*, was viewed by the Court as slightly too far-reaching. They prohibited the executives from engaging or participating in "any business the Company and/or its subsidiaries are engaged in or have taken steps to be engaged in prior to the Executive's termination of employment." As the primary purpose of the non-competes was to bar the executives from establishing a competing car club, the Court determined the language extending the restriction to unrelated businesses was overly broad. Thus, it declined to apply the restriction on subsidiaries of Fortegra and enforced the remainder of the agreements. As a practical

matter, the Court restricted the executives from being engaged in the car club market in which they had worked for their previous employer.

The Court also concluded the executives did not establish they resigned for “Good Reason,” in part, because the agreements provided Fortegra with a cure period, which the executives did not utilize. Further, since the executives hired a third party to copy all of the data from their Fortegra-owned computers at work to recently purchased personal laptops, and did not return that information upon their departures from Fortegra, the Court denied the executives any severance pay under their agreements, finding their actions fell within an exclusion to the severance provision of their agreements.

Dill highlights the importance of properly drafted choice-of-law and choice-of-forum (identifying the court selected to hear disputes arising under the agreement) clauses, as well as appropriate non-competition restrictions, and recognizes the importance of initiating litigation quickly in a preferred forum. While Continental Car Club ultimately prevailed, it might have increased its chance of success if it litigated promptly in the preferred forum rather than reacting after the former executives filed suit. National employers should consider reviewing their agreements on a state-by-state basis since a single national agreement may not satisfy the restrictions recognized in all states. Employers also should consider reviewing their restrictive covenants to determine if they adequately protect business interests or whether they should be strengthened. If you have any questions about drafting or litigating non-competition agreements or need assistance in taking steps to increase the likelihood that your business information will be protected, please contact the Jackson Lewis attorney with whom you regularly work.

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