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Trends in U.S. Common Law: When is a Non-Compete Agreement an Unreasonable Restraint?

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ESPN, whose corporate headquarters are located in Bristol, Connecticut, like many other international news and entertainment organizations does not employ their own security force to protect the facility and employees: they employ contract security agencies. Guardsmark, LLC lost the bid to renew the contract in September 2006 to Securitas Security Services USA. The contract with Guardsmark expired in December 2006, and employees were told that they could not seek employment with the new company because of a non-compete provision in their employment contracts. The plight of these lower paid individuals came to the attention of Connecticut's Attorney General through a number of news articles in the Hartford Courant and a local employee group. The debate over non-compete agreements has become fodder for legislators and legislation will change the future of the application of the common law in the state and as precedent as other states follow suit.

Field of Research: Business Law

1. Introduction

The events of September 11th spawned a proliferation in the private security industry. Dozens of security consulting firms, security experts and security providers have evolved into a significant industry. *"Hawking services that range from providing total security audits to planning escape routes for workers in case of attack, the consultant corps is raking in millions in fees as companies gird for the worst. Estimates now put private*

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spending for all forms of security at $50 billion annually, two or three times the pre-September 11 tally, with a sizeable chunk going for consulting services. A March, 2005 Conference Board report found that more than half of companies surveyed had boosted their security spending, with the biggest hikes among large outfits in such high-risk industries as utilities and financial services, especially in the Northeast."[1]

Fear was further promulgated by the July 7, 2005 bombings of the London subway system. Experts emerged from every sector, particularly from former government ranks. The list is long and includes such notables as; Rudolph W. Giuliani, former Mayor of New York City, James Loy and Asa Hutchison who headed border and transportation security in the Department of Homeland Security.[2] Government regulation has contributed significantly to the growth of the industry with the passage of the Terrorism Risk Insurance Act in 2002, "which required insurers to offer terrorism coverage, forcing them to figure out risks for specific incidents."[3] Additionally the Private Security Officer Employment authorization Act of 2004 allowed private security firms to seek national security check information on current and prospective employees through the Department of Justice. [4]

Even the Department of Homeland Security sought assistance from the private sector, in particular as it relates to the technology infrastructure of the nation, when Secretary Ridge noted that "private companies control 85 percent of the nation's cyber resources."[5] Private security companies are protecting much of the country's infrastructure which includes nuclear power plants, telecommunications systems, water treatment and distribution systems, bridges, tunnels: the list is long. Private industry utilization is equally diverse: entertainment facilities, pharmaceutical companies, chemical manufacturing plants, banking and financial services to name just a few.

Guardsmark, LLC is a privately owned business, established in 1963 by Ira A. Lipman, who serves as the company's chief executive officer, chairman and owner. The business was a public company from 1970 to 1979, but is now organized as a limited liability company with headquarters located in New York City, Beverly Hills, California and Memphis, Tennessee. Lipman maneuvered his company into the forefront of the industry by following some of the principles espoused by Tom Peters in his most recent publication, *"Business Excellence in a Disruptive Age"*.[6] In the calendar year 2006 Guardsmark employed over 19,000 employees and earned revenues in excess of $548 million, placing it as one of the top five security companies in the United States. It reports operating 155 branch offices in the United States, Canada and Puerto Rico.[7] Guardsmark claims to be the largest employer of former FBI

agents in the world and "actively recruits former members of the US Secret Service, CIA and from all branches of the US military into its management team."[8]

Guardsmark has an active litigation history and is a named plaintiff or defendant in forty-one reported cases in both federal and state courts. The issues addressed by the cases brought by both current and former employees range from sexual harassment, racial discrimination, wrongful termination, retaliatory discharge, denial of temporary disability, wrongful constructive discharge, age discrimination, sex discrimination, to denial of workman's compensation benefits. Guardsmark's litigation history ranges beyond employee relations and includes service providers such as insurance companies, competing service firms and the National Labor Relations Board to name a few. The company claims operations in over 400 cities in the US and its undisclosed client list included such notables as the Disney Corp and ESPN and provides not only contract security service, but also investigation and screening of employees, facility consulting and executive protection services.

2. Literature Review

The majority of legal and academic discourses concerning the validity of non-compete agreements are sourced in states that have recently adopted statutes to limit and redefine the applicability of the common law application of covenants not to compete. Connecticut joined California and Florida by adopting Public Act 07-237 (formerly House Bill 6989) in the 2007 Legislative Session, An Act Concerning Non-Compete Agreements.

3. Methodology and Research Design

A significant body of case law is emerging from a number of states as the courts examine the current applicability of non-compete clauses and their use in modern business practices.[9] Both Texas and Missouri have taken an alternate approach to modification of the common law doctrines by judicial interpretation and limitation.[10] This analysis focused on the seminal case in Connecticut, national litigation of the defendant and the ultimate outcome of legislative modification of the common law through statutory limitation.

4. Discussion of Findings

When ESPN's contract with Guardsmark came up for renewal, ESPN chose a competitor, Securitas Security Services USA to provide security services to its facilities. The contract with Guardsmark was to end in

December 2006 and the 140 employees found that they had only two real options: be reassigned by Guardsmark to another location, or lose their jobs. While Guardsmark ultimately did successfully relocate a number of employees formerly assigned to ESPN, many faced the reality of being unemployed at the end of the contract. How could this happen when Securitas openly encouraged the Guardsmark security force to apply for positions when they won the contract from Guardsmark?

What came to light was the employment contract that Guardsmark requires employees to sign prohibiting their employees from taking employment with a competing firm at a location where they were stationed by Guardsmark for a period of one year. While Securitas was not prevented from hiring the ex-Guardsmark employees, they could only do so if they employed them at a location other than ESPN. It became a high profile news story and a group of Guardsmark employees formed a group called "The Concerned Officers Group" meeting with the press and contacting the State's Attorney General, Richard Blumenthal for help.

The Guardsmark non-compete provision reads in part,

"Employee hereby agrees that following the termination of employment with Guardsmark, whether voluntary or involuntary, for a period of one year thereafter he (she) will not perform or hire others to perform any security services at the site, place or location where he (she) performed security services within the immediate preceding (12) months of his (her) employment with Guardsmark."[11]

Jeremy Lovell, a Hartford Guardsmark manager explained that, "Guardsmark's non-compete clause is intended to prevent rivals from underbidding them for work. If a competitor knows it can easily hire away Guardsmark employees, it might reduce its bid by the amount that it would otherwise spend on recruitment and training."[12] While the employer under the common law certainly may have interests they are entitled to protect, restrictive covenants are generally analyzed under the following criteria:

1. Is the restraint no greater than necessary to protect the employer's legitimate interests?
2. Does the agreement unduly restrict the former employee in his or her ability to earn a livelihood?
3. Is the restraint reasonable from the standpoint of public policy?[13]

Not surprisingly, the assertions of Guardsmark raised considerable angst at the office of Attorney General Richard Blumenthal, who unsuccessfully recommended the company not enforce its contractual provisions in a letter to the CEO, Ira Lipman,

"The enforceability of the non-compete clause in this particular circumstance in Connecticut is legally challengeable and highly questionable as a matter of business ethics. The only consequence of enforcing your non-compete clause in this situation will be to harm loyal

employees who are suddenly no longer needed by you. Only is Guardsmark offers other comparable employment to these employees would its position seem more reasonable."[14]
Since Guardsmark had successfully litigated in Connecticut under similar circumstances, confidence as to the enforceability of their contractual provisions allowed them to ignore the requests of the Attorney General.

The case, Guardsmark, Inc. v. Effective Security Systems, Inc.[15] was an action for injunctive and other relief against a competitor (Effective Security Systems) who had hired former Guardsmark employees after acquiring a contract from Guardsmark at an IBM facility. The employee defendants claimed that they did not have the opportunity to fully read the provision; the employer did not fully explain the provisions and they generally thought the paperwork was routine in nature. The court reasoned that these defendants made no supportable claims for fraud or misrepresentation and therefore violated the covenant voluntarily and knowingly. The defendant further argued that Guardsmark has not shown irreparable harm and was not entitled to injunctive relief. To that claim the court opined, "It appears to be well settled in Connecticut law that in actions to enforce restrictive covenants, the irreparable harm would result from the breach of the defendants' (employees') promises."[16] The court further stated that this covenant had been tested successfully for Guardsmark in Arkansas, Michigan, Oklahoma, Tennessee and Texas, finding the restrictive covenants both reasonable and fully enforceable. [17]

An overall sense of frustration and outrage, fueled in part by the persistent exposure in the press[18], advanced the issue beyond threatening letters, when Attorney General Blumenthal introduced a bill to the Connecticut legislature that would limit an employer's ability to require non-compete agreements as a condition of employment. The proposed bill, known as the "Guardsmark" bill, was introduced in January 2007 and successfully passed through two public hearings and three committees and was referred to the Office of Legislative Research and Office of Fiscal Analysis for input. [19] At the conclusion of the 2007 legislative session, Public Act 07-237[20] was passed and became effective October 1, 2007. While the original proposal was applicable to all non-compete agreements, the act as adopted was limited to the security industry and broadcast employees.[21] The bill effectively requires the employer to prove that the employee has obtained trade secrets of the employer in order to require the employee to execute the restrictive covenant. Both the aggrieved employee and the Attorney General can initiate an action for any violation and seek both injunctive and equitable relief. Additional provisions were added to the bill in its last session which specifically added "broadcast industry employee" language that did not prove harmful to the final adoption of the bill in its entirety.

5. Conclusion

Courts are increasingly revisiting the reasonableness of the restraint and frequently attempting to define and redefine public policy concerns. Like Connecticut's recent attempt to clarify limitations on these widely held concepts, two other states, California and Florida have successfully passed legislation which require employers to prove that the employee should be subjected to such restrictive covenants.

Endnotes

[1] Paul Magnusson, Spencer E. Ante, Michael Arndt, Stan Crock, Emily Thornton, *Business Week,* "The Booming Security Business, July 25, 2005. "Last year, for example, Goldman Sachs & Co. spent $9 million installing dozens of metal posts and two 200-foot-long Italian granite planters to protect just one office building in Jersey City after a consultant recommended hardening against car bombs."

[2] *Id.* at 2.

[3] *Id.*

[4] David Bates, New Law Allows Nationwide Checks by Security Firms, *Government Security News, ( ).*

[5] Grant Gross, IDG News Service, *InfoWorld,* "Ridge Asks for Help at Homeland Security", April 30, 2003.

[6] Bruce Rosenstein, "Peters Principles Can help You Create Your Brand", *USA Today,* (11/17/03). "One way that companies, whether they are giants or one-person operations, can distinguish themselves, he says, is by becoming a professional service firm or PSF. In this model, you break out of cost center/overhead hell by focusing on providing service solutions other companies will pay for."

[7] Our President, www.guardsmark.com

[8] Press Release, www.guardsmark.com

[9] CGS, § 35-51(d), "The law defines trade secret as information, such as a formula, device, process, or customer list, that (1) has economic value because it is not generally known and not readily ascertainable by others who could benefit from it and (2) is the subject of reasonable efforts to keep it secret. "

[10] Foss, Todd M., *Texas Covenants Not to Compete and the Twenty-first Century: Can the Pieces Fit Together in a Dot.com Business World?,* Houston Business and Tax Law Journal, Vol. 3, 2003.

[11] 92-CBAR-1370, Guardsmark, Inc. V. Effective Security Systems, Inc. 7 Conn.L.Rptr.772 (1992).

[12] Eric Gershon, "ESPN Guards Can't Stay; Departing Contractor Invokes Non-Compete Clause", *Hartford Courant,* pE1, November 4, 2006.

[13] Douglas M. Nabham, Aron S. Walters, "Covenants Not to Compete – They Ain't What They Used To Be", Williams Mullen, 2007.

[14] Eric Gershon, "ESPN Guards Can't Stay; Departing Contractor Invokes Non-Compete Clause", *Hartford Courant,* pE1, November 4, 2006.

[15] 92-CBAR-1370, Guardsmark, Inc. v. Effective Security Systems, Inc. 7 Conn.L.Rptr.772 (1992).

[16] *Matts v. Lally,* 138 Conn. 51, 56 (1951). "This principle evolved from an earlier case *Torrington Creamery v. Davenport,* 126 Conn. 515 (1940), where at page 521, the court stated that a restrictive covenant is a valuable business asset which is entitled to protection."

[17] 92-CBAR-1370, Guardsmark, Inc. v. Effective Security Systems, Inc. 7 Conn.L.Rptr.772 (1992).

[18] Eric Gershon, "Guards Let Down After Losing Contract, Security Firm Refuses to Let its Workers Stay at ESPN", *Hartford Courant*, pA1, December 4, 2006.

[19] Raised H.B. NO. 6989, An Act Concerning Non Compete Agreements, Session year 2007.

[20] *Id.*

[21] "The act prohibits an employer from requiring an employee who is a security guard to agree to a non-competition agreement if (1) it prohibits the employee from having the same or a similar job at the same location and (2) the job is for another employer or as a self-employed person. This prohibition does not apply if the employer proves that the employee has obtained the employer's trade secrets.

The act allows someone to sue under this provision is Superior Court for damages, an injunction, and equitable relief, as the court deems appropriate, for violations. It also allows the labor commissioner to ask the attorney general to sue in the Hartford Superior Court for restitution on behalf of an injured person, injunctions, and equitable relief, as the court deems appropriate.", Office of Legislative Research, Public Act Summary Book, (2007).