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HR ADVANTAGE™

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Victory in Wisconsin Supreme Court Makes It Easier to Enforce Covenants Not to Compete



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A recent decision by the Wisconsin Supreme Court, a case in which DeWitt Ross & Stevens S.C. represented the employer, will make it easier for Wisconsin employers to enforce covenants not to compete in employment contracts.

In *Star Direct, Inc. v. Dal Pra*, the Wisconsin Supreme Court held that the fact that one covenant not to compete in an employment contract is unreasonable and unenforceable does not necessarily mean that any other covenant not to compete in the employment contract is also unenforceable. To understand the significance of the *Star Direct* case and how employers can use it to draft covenants not to compete that are more likely to be enforced by a court, this article will briefly describe (1) Wisconsin law regarding covenants not to compete, (2) the facts of the *Star Direct* case and the Supreme Court's decision, and (3) the practical implications of the *Star Direct* case.

Legal Background

Covenants not to compete (also called restrictive covenants or non-compete agreements) are considered to be restraints of trade and to be enforceable must be strictly construed to determine whether they are reasonable. Under Wis. Stat. § 103.465, non-compete agreements

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in employment contracts are “lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer.”

Many cases of the Wisconsin Supreme Court have established that for a restrictive covenant to be enforceable it must: (1) be necessary for the protection of the employer; that is, the employer must have a protectable interest justifying the restriction imposed on the activity of the employer; (2) provide a reasonable time limit; (3) provide a reasonable territorial limit; (4) not be harsh or oppressive as to the employee; and (5) not be contrary to public policy.

Another important principle in Wis. Stat. § 103.465 is that “[a]ny covenant . . . imposing an unreasonable restraint is illegal, void and unenforceable even as to any part of the covenant or performance that would be a reasonable restraint.”

In a 1984 case, *Streiff v. American Family Mutual Insurance Company*, the Wisconsin Supreme Court held that, when different clauses of a covenant not to compete are indivisible, if any one clause is unreasonable, each of the clauses are unenforceable. In *Streiff*, however, the clauses were cross-referenced and intertwined and it was not possible to understand one clause without referring to the other clauses. Therefore, the Supreme Court held that the provisions were “intertwined and the covenant must be viewed in its entirety, not as divisible parts.”

In a 2001 case, *Mutual Service Casualty Insurance Company v. Brass*, the Wisconsin Court of Appeals purporting to apply *Streiff*, held that two clauses were intertwined and indivisible when “they govern several similar types of activities and establish several time and geographical restraints.” Thus *Brass*, made it very likely that if an employment contract contained two different covenants not to compete—or perhaps even a covenant not to compete and a confidentiality clause that prevented an employee from using confidential information to compete with the employer—if any one of them was

held to be unreasonable, both of them would likely be unenforceable.

The *Star Direct* Case

Star Direct is in the business of distributing assorted novelties and sundries to convenience stores, service stations, truck stops, and travel centers throughout the Midwest. This business is competitive and its business model is premised on the relationship between route sales people and their customers. The route sales people regularly visit customers and potential customers, work to understand their customer’s business, and endeavor to build long-term personal and professional relationships with them.

Dal Pra was a route sales person employed by CB Distributors until his route was purchased, along with one other route, by Star Direct. Star Direct wished to retain the business on these routes, so it offered Dal Pra what he admitted was a “very good package.” This employment offer included a nearly identical route—the area within a 50 mile radius of Rockford, Illinois—as well as a \$30,000 bonus upon the completion of 30 months of service. Dal Pra accepted the offer.

Dal Pra signed an employment agreement that included two covenants not to compete and a confidentiality clause. The first covenant not to compete—that the Supreme Court referred to as “the customer clause”—provided as follows:

[F]or twenty-four (24) months, after termination of Employee’s employment with Employer, Employee shall not interfere with, or endeavor to entice away from Employer any person, firm, corporation, partnership or entity of any kind whatsoever which is a customer of Employer or CB Distributors, or which was a customer of Employer or CB Distributors within a period of time of one year prior to the termination of Employee’s employment with Employer, for which Employee performed services or otherwise dealt with on behalf of Employer or CB Distributors or relative to

which Employee obtained special knowledge as a result of his position with Employer; and Employee shall not approach any such customer or past customer for any such purpose or knowingly cooperate with the taking of any such action by any other person, firm, corporation, or entity of any kind.

The second covenant not to compete—that the Supreme Court referred to as the “business clause” — provided as follows:

[F]or a period of twenty-four (24) months after termination of Employee’s employment with Employer, Employee shall not, directly or indirectly . . . become engaged in any business which is substantially similar to or in competition with the business of the Employer, within a fifty (50) mile radius of Rockford, Illinois.

The Supreme Court held that the “business clause” was unenforceable because it reasoned that by precluding Dal Pra from engaging “in any business which is substantially similar to or in competition with the business of [Star Direct], within a fifty (50) mile radius of Rockford, Illinois” the covenant was broader than necessary to protect Star Direct. That is, because the covenant used the words “substantially similar to” **or** in “competition with” Star Direct’s business, it necessarily precluded engagement in a business that was **not** in competition with Star Direct and, therefore, was not reasonably necessary to protect Star Direct.

The Supreme Court held that the “customer clause” was, however, reasonable. In doing so, the Supreme Court recognized that Star Direct had a legitimate interest in winning back the business of recent past customers and that, therefore, it was reasonable for Star Direct to prohibit Dal Pra from soliciting people who had been customers of Star Direct within the year prior to termination of his employment and with whom he had dealt and/or about whom he had acquired “special knowledge” about as a result of his employment.

The Supreme Court also held that the “customer clause” was separate and indivisible from the “business clause”

as well as the “confidentiality clause” because they each protected different interests of Star Direct and each of them could be independently read and enforced. The “business clause” prohibits Dal Pra from engaging in a competitive business or substantially similar business in Dal Pra’s former sales territory. The “customer clause” is focused on protecting Star Direct’s relationships with recent past customers, which could be undermined by the efforts of a former employee if unchecked. The “confidentiality clause” prohibits the use or disclosure of confidential information.

Thus, even though there was certainly some substantial overlap and even though the activities prohibited by each provision were similar, the Supreme Court overruled *Brass*. The new rule established in *Star Direct* is that “restrictive covenants are divisible when the contract contains covenants supporting different interests that can be independently read and enforced.” The case recognized that employers may have several protectable interests that apply in similar, though not exactly the same, situations and it makes sense to set these out in separate post-termination restrictive covenants

Implications of *Star Direct* for Employers

Star Direct is an important case. Indeed, in promoting a continuing legal education seminar titled, “Star Direct Wars: Litigation of Restrictive Covenant Cases After *Star Direct*,” the State Bar of Wisconsin has said “[t]he *Star Direct* case is the most important case interpreting Wis. Stat. Sec. 103.465 in the last 25 years. . . .” And, an article in *Capital Region Business Journal* argues that “[t]he *Star Direct* decision opens the courthouse doors to employers looking to enforce their restrictive covenants.” More specifically, the implications of the *Star Direct* decision for employers include the following:

- Although Wisconsin law disfavors restrictive covenants and will construe them in favor of employees, courts

must interpret them reasonably so as to avoid absurd results, giving the words their plain meaning reading as a whole, and giving effect where possible to every provision;

- An employer can have a legitimate protectable interest in its relationship with recent past customers as well as its current customers;
- An employer can have a legitimate protectable interest in protecting special knowledge its employees may have about its customers such as their specific product needs, product desires, and pricing information;
- Employers can have different legitimate protectable interests that can be protected by separate restrictive covenants in an employment agreement;
- The fact that one restrictive covenant in an employment agreement is unreasonable and unenforceable does not necessarily mean that every other restrictive covenant in

the employment agreement will be unenforceable;

- Different restrictive covenants in an employment agreement are separate and indivisible—even if they overlap—if they serve different interests of the employer and the separate covenants can be independently read and enforced;
- The fact that every employee (or sales person) is not subject to a restrictive covenant does not necessarily mean that a restrictive covenant with certain employees is not reasonably necessary to protect the legitimate interest of the employer;
- Restrictive covenants must be carefully drafted to protect the interest of the employer because as shown by the inclusion of the words “substantially similar to or in competition with” in the “business clause” even one or two words can render a restrictive covenant unenforceable; and
- Restrictive covenants must be regularly reviewed and revised in light of changing developments in the law and changing circumstances of the employer.

The last point is particularly important for employers. A restrictive covenant may have been enforceable when it was drafted, but may no longer be enforceable. This could be so because of changes in the case law. Or, it could be that the employer’s business or the employee’s duties and responsibilities have changed such that a restriction that was reasonably necessary to protect the employer’s interest a few years ago is no longer necessary or is now more restrictive than is necessary.

Or, as a result of the *Star Direct* case, it may be that an employer might recognize that it has different protectable interests that could be protected by separate restrictive covenants in an employment agreement. Because each of these restrictive covenants can now be analyzed and enforced separately, there may now be good reason to include them in an employment agreement.

The Red Flags Rule Your Business Should be Prepared to Comply by June 1, 2010.

Effective June 1, 2010, Federal law (commonly referred to as “The Red Flags Rule”) will require every business that extends credit to a customer or provides goods or services and bills the customer later to adopt an *Identity Theft Prevention Program* to prevent or mitigate identity theft.

Further information about the Red Flags Rule, including what businesses are covered, what programs must entail and penalties for noncompliance will follow in the next *HR Advantage*.

There is no such thing as a “standard” restrictive covenant or a “boiler plate” form. Every restrictive covenant must be narrowly and carefully drafted to protect the specific legitimate interest of the employer in a manner that is reasonable given the specific situation. An attorney drafting a restrictive covenant should have not only an understanding of the manner in which restrictive covenant cases are litigated, but also an understanding of the employer’s business. At DeWitt Ross & Stevens S.C., for example, members of the Business Practice Group often work with members of the Labor and Employment Relations and Litigation Practice Groups

to prepare restrictive covenants that are carefully drafted to meet the specific needs of our clients.

Robert E. Shumaker is the Co-chair of the DeWitt Ross & Stevens S.C. Litigation Practice Group and a member of the Labor and Employment Relations Practice Group. He was the lead counsel for Star Direct and successfully argued the case described above before the Wisconsin Supreme Court. For more information about restrictive covenants, contact Mr. Shumaker or any member of the DeWitt Ross & Stevens S.C. Labor and Employment Relations Practice Group.

EEOC Issues Proposed Regulations Under the Americans with Disabilities Amendments Act



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Recently, the Equal Employment Opportunity Commission (“EEOC”) published proposed regulations under the ADA Amendments Act (“Act”). As you will recall, Congress passed the Act back in September 2008 and it went into effect on the first of this year.

Generally, the Act expressly rejected several Supreme Court decisions that had narrowly construed the term “disability” and the ADA itself. The Act also explicitly broadened the ADA in order to protect a greater number of individuals under its net. In the Act, Congress directed the EEOC to issue regulations to assist in implementing the sweeping changes to the ADA. Not surprisingly, the EEOC regulations echo that of the ADA at the very outset, stating that the “definition of disability in this part shall be construed broadly, to the maximum extent permitted by the terms of the ADA.”

At present, the EEOC regulations are mere proposals; the EEOC is seeking comment on them through November 23,

2009. Barring a major uproar over the regulations, they will likely be finalized shortly thereafter. Below are some of the highlights from the proposed regulations:

Defining “Substantially Limits”

The ADA provides that an impairment is a disability if it “substantially limits” an individual’s ability to perform a major life activity. The term “substantially limits” previously had been interpreted by courts as “significantly restricts,” which resulted in many ADA claims being dismissed early in litigation for failure to show that an individual was, in fact, disabled under the ADA. The Act takes the opposite approach.

Accordingly, the proposed rules describe the Act as shifting the “focus of an ADA case” to the question of “whether discrimination occurred, not on whether an individual meets the definition of ‘disability’.” They also suggest that the question of whether an individual is “substantially limited” in a major life activity “should not require extensive analysis” and “often may be made using a common-sense standard, without resorting to scientific or medical

evidence.” Consistent with that theme, another proposed rule states that the relevant inquiry is “how a major life activity is substantially limited, not on what an individual can do in spite of an impairment.”

In line with this theme, the proposed rules further minimize the impact of “substantially limits” in the following ways:

- If an individual can demonstrate that his/her impairment substantially limits a major life activity, s/he does not also need to demonstrate a limitation in the ability to perform activities of central importance to daily life.
- Where an impairment substantially limits one major life activity, it need not also limit other major life activities to qualify as a disability under the Act.
- An impairment may be substantially limiting even if it is temporary in nature. The rules reject the concept of a durational minimum, expressly stating that “an impairment may

substantially limit a major life activity even if it lasts, or is expected to last, for fewer than six months.” Another of the rules thankfully qualifies the former rule by stating that “temporary, non-chronic impairments of short duration with little or no residual side effects ... usually will not substantially limit a major life activity.”

- Working is a major life activity and should no longer require extensive analysis. The rules also make mention that “the fact that an individual has obtained employment elsewhere is not dispositive of whether an individual is substantially limited in working.”

Expanding “Major Life Activities” and Adding “Major Bodily Functions”

While the Act itself added several new activities to the non-exhaustive list of “major life activities,” the proposed regulations not only mirror those of the Act but add three more to the list: sitting, reaching and interacting with others. The regulations also add the additional major bodily functions of special sense organs, skin, genitourinary, cardiovascular, hemic, lymphatic and musculoskeletal systems.

In addition, the proposed rules list a number of conditions that “will consistently meet the definition of disability” based on “certain characteristics associated with these impairments,” including:

- Autism
- Cancer
- Cerebral palsy
- Epilepsy
- HIV
- AIDS
- Multiple sclerosis
- Muscular dystrophy
- Major depression
- Bipolar disorder
- Post-traumatic stress disorder
- Obsessive-compulsive disorder
- Schizophrenia

Ironically, the original ADA had rejected any notion of a “per se” disability.

Don't Fail to Report Retirement Funds in Foreign Accounts!

If you are a trustee of a retirement plan (such as a 401(k) plan, pension plan, or even an individual retirement account), and the plan has investments in a foreign account, then you are required to file a Report of Foreign Bank and Financial Accounts (FBAR) with the Internal Revenue Service by June 30 each year. The IRS recently announced that a foreign account includes a mutual fund or other commingled fund, such as an offshore hedge fund. The providers of mutual funds or other foreign accounts generally will not file the FBAR on behalf of investors. Because of confusion about the filing requirement, the IRS has extended the filing deadline for the 2008 year until September 23, 2009. Penalties for failure to file are severe. Contact your attorney for guidance as to whether your retirement plan holds the kind of account for which the FBAR must be filed.

Mitigating Measures and Episodic Impairments/Impairments in Remission

Consistent with the Act's proclamation that mitigating measures such as medications, prosthetics, corrective surgery, hearing aides and mobility devices should no longer be considered in assessing whether an individual is disabled, the proposed rules state that individuals must be assessed in their unmitigated state when making the determination. (Note that eyeglasses and contact lenses are excluded from this exception.)

Similarly, and in accord with the Act, the rules identify several non-exhaustive examples of impairments that are episodic in nature or are conditions in remission, including:

- Epilepsy
- Hypertension
- Multiple sclerosis
- Asthma
- Cancer
- Psychiatric disabilities such as depression, bipolar disorder and post-traumatic stress disorder.

"Regarded As" Analysis

The Act itself significantly expanded coverage for individuals "regarded as disabled" by prohibiting discrimination based on the employer's alleged perception of a mental or physical impairment, even if that impairment is not perceived as an actual disability. As an example, while the flu may not rise to the level of a major life activity, that ailment could, nonetheless, give basis to a "regarded as" claim.

The proposed rules, therefore, state that proof that an individual was denied employment because of an impairment is sufficient to establish coverage under the ADA, even "without evidence that the employer believed the individual was substantially limited in any major life activity."

Like the Act itself, the proposed rules state that there is no duty to provide reasonable accommodations to those "regarded as" having a disability. However, the EEOC goes beyond the Act in requiring that employers reasonably accommodate those with a "record of" disability absent undue hardship. How or why an employer can accommodate an individual with a record of a disability if that individual is not presently disabled is illogical, however, and hopefully will be removed at the time the rules are finalized.

How Do the Rules Impact You?

The EEOC regulations come as no surprise on the heels of the Act's drastic expansion of the original ADA. The proposed rules underscore Congress' intent to shift the focus from whether an individual is disabled to whether the individual's employer unlawfully discriminated against the individual. Aside from some quirks in the rules that likely will be meted out before finalization, they are consistent with the Act, providing no cover from the Act's expansive interpretation of the ADA.

Employers are well-advised to ensure that their managers, supervisors and HR departments are well-versed in how to treat individuals claiming an ailment or impairment. While before a decision not to promote, not to hire or to terminate an individual may not have been analyzed in litigation prior to the Act because the individual was held not to be disabled under the ADA, such employment decisions will now be reviewed, and with scrutiny. Such a shift in the pendulum requires that employers take extra measures to document misconduct, enforce its policies even more uniformly, and instruct their supervisors to provide objective and thorough employment evaluations.

Should you have any questions or need some assistance, feel free to contact your regular DeWitt Ross & Stevens employment attorney or the author.