

No-Hire Clauses Must Pass Non-Compete Scrutiny

Jan 01 2003

Practice Area: Health Law & Health Industry Labor, Employment and Immigration & Labor and Employment

Summary

On December 27, 2002, the Supreme Court held that no-hire clauses between employers that affect employees must be (1) necessary to protect the employer; (2) provide a reasonable time limit; (3) provide a reasonable territorial limit; (4) not be harsh or oppressive to the employees; and (5) not be contrary to public policy. Importantly, the employees must also have knowledge of, and consent to, the restriction and must receive consideration for acceptance of the restriction. In its ruling, the Supreme Court upheld the Court of Appeals decision in *Hyde Companies, Inc. v. Dove Healthcare, LLC*, which we reported on in our bulletin earlier this year. Simply stated, the Supreme Court held that for no-hire provisions to be enforceable, employees who are the subject of the restrictions must be aware of the restriction, consent and be provided consideration.

Analysis

The no-hire provision at issue was contained in an agreement between Dove Healthcare, LLC, a healthcare provider that operates nursing homes ("**Dove**" or "**Nursing Home**") and Hyde Companies, Inc. (d/b/a "**Greenbriar**") which furnishes physical therapists to nursing homes ("**Therapy Company**"). The provision read as follows:

"Dove acknowledges and agrees that it will not, directly or indirectly, solicit, engage, permit to be engaged or hire any Greenbriar therapist or therapist assistant to provide services for Dove independently, as an employee of Dove or as an employee of a service provider other than Greenbriar or otherwise during the term of this Agreement . . . and for a period of one year thereafter without the written prior consent of Greenbriar. If, after prior to written consent by Greenbriar, any Greenbriar therapist or therapist assistants are hired or utilized by Dove, Dove shall pay Greenbriar a fee of 50% of the subject Greenbriar's employee annual salary."

The Supreme Court analyzed the provision under Wisconsin Statute Section 103.465, titled "Restrictive Covenants in Employment Contracts." Therapy Company argued that the Court should not apply the statute to the no-hire provision at issue because the agreement was between Therapy Company and Nursing Home, not Therapy Company and its employees. The majority of the Court, in a 5-2 decision, rejected this argument because it found that the explicit purpose of the statute is to invalidate covenants that impose an unreasonable restraint on employees. Therapy Company's attempt to restrict its employees through a no-hire provision with Nursing Home (instead of a restrictive covenant with its employees directly) implicates the Restrictive Covenants statute since the effect of the no-hire provision was to restrict their employment.

In determining whether the provision was enforceable, the Court employed and reaffirmed the fivefactor test that is generally used to evaluate covenants not to compete. This test requires that the restrictive covenant be (1) necessary to protect the employer; (2) provide a reasonable time limit; (3) provide a reasonable territorial limit; (4) not be harsh or oppressive to the employee; and (5) not be contrary to public policy. The Court also considered and used the canons of construction that are generally applied to restrictive covenants. The canons are: (1) that restrictive covenants are prima facie suspect; (2) they must withstand close scrutiny to pass legal muster; (3) they will not be construed to extend beyond their proper import or further than the language of the contract absolutely requires; and (4) that they will be construed in favor of the employee.

The Supreme Court agreed that some kind of restriction on Therapy Company's employees may have been necessary to protect Therapy Company's business and investment, but determined that Therapy Company could have adequately protected itself directly through a reasonable covenant not to compete with its employees that complied with the statute. Therefore, the no-hire provision with Nursing Home was not necessary for Therapy Company's protection. The Court did, however, accept the one-year time limit as reasonable.

With regard to the territorial restriction, the court found that the restriction on employees with whom Nursing Home had had no prior contact was an unreasonable territorial restriction. The no-hire provision restricted all of Therapy Company's therapists and therapist assistants, not only those providing services at Nursing Home. One of Therapy Company's former employees, who was the subject of the dispute between the two companies, had never provided services at the Nursing Home facility prior to Nursing Home's hiring of that employee.

Finally, the Court found that the no-hire provision was harsh and oppressive to Therapy Company's employees. The Court also deemed its enforcement to be contrary to public policy. It based its finding largely on the fact that the employees had no knowledge of the nohire provision, that Therapy Company did not seek consent from the affected employees and that the employees were not provided consideration for the restriction as required for a valid contract.

Impact on Wisconsin Employers

As we reported in our earlier bulletin, this case is particularly noteworthy because similar no-hire provisions are rather common in service contracts where one employer is providing leased and temporary employees to another company. In an effort to protect its investment in retaining, training and maintaining the expertise of those employees, the main employer often seeks a commitment from the company contracting for those services that it will not directly hire its employees while the service agreement is in place or for a time period thereafter. While the Court agreed that parties are generally free to contract as they see fit, this right is conditioned upon the contract not imposing obligations that are contrary to public policy. Those contracts that violate public policy, as here, are not enforceable.

Helpful Hints from the Supreme Court

This case offers some helpful insight as to how employers may protect their human resources from competitors in a manner that will be enforceable if challenged. First, the employee must have knowledge of the restriction to which he or she is subject. Second, the employee must consent to that restriction. Third, the employee must be provided consideration. For at-will employees, your offer of employment may be sufficient consideration if the employee's acceptance of the restriction is a condition of employment. If you already have employees that are subject to similar restrictive covenants, you may be able to create an enforceable arrangement by informing the employee of the restriction; seeking their consent; and offering a bonus, additional specialized training, additional benefits, or some other benefit or reward as consideration for their acceptance. The special benefit should only be offered to those who accept the restriction. Fourth, the restrictive covenant should satisfy the requirements of the Restrictive Covenants statute. The Court suggested that it would not enforce a restriction that interfered with employees who sought employment at facilities where they had no prior experience. Thus, we suggest that you only restrict employees from future employment at facilities or with companies with whom the particular employee has developed a significant relationship.

The holdings of this case are now the law in the State of Wisconsin. Thus, you should determine whether any of your current contracts have such a clause. If so, consider whether the enforceability of the clause is important. If it is, you should consider whether the employees who are subject to the restrictive covenant are aware of the restriction, have consented to the restriction and have received adequate consideration for the restraint. If not, you should consult with counsel regarding the steps that may be taken to support the enforceability of the no-hire clause.

If you are the recipient of services provided by employees of other companies and there is a no-hire restriction in your service agreement, it may not be enforceable under Wisconsin law. This may be particularly true if the company is based outside of Wisconsin and is not familiar with Wisconsin law. Again, in those situations and in future contracting situations, if the enforceability of a no-hire clause is pertinent to your business and strategic planning decisions, we advise you to consult counsel to discuss your options and to craft no-hire and non-competition provisions with this case in mind.

Finally, a no-hire clause in an employment contract which restricts the employee from hiring their employer's other employees (to assist the restricted employee in a competing business), may invalidate non-competition, nonsolicitation and other restrictive covenants if the employees affected by the no-hire clause have not consented to and have not received consideration for the restriction on their employment opportunities.

von Briesen & Roper Legal Update is a periodic publication of von Briesen & Roper, s.c. It is intended for general information purposes for the community and highlights recent changes and developments in the legal area. This publication does not constitute legal advice, and the reader should consult legal counsel to determine how this information applies to any specific situation.