

Response to Gillian Lester and Stewart J. Schwah: An Indiana Perspective

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Litigation over restrictive employment covenants normally does not involve statutory construction. Thus, the judicial task has evolved into the use of a reasonableness test and the often uncritical application of certain legal principles, some of which are of considerable vintage, in deciding whether to enforce a particular restriction. Those who seek objectivity and predictability in adjudication find troublesome the application of such broad judicial discretion as is inherent whenever a court makes a judgment that a restriction is or is not "reasonable."

Professor Gillian Lester's thoughtful discussion explores the question of whether and when courts should enforce restrictive covenants and the economic considerations that should, but often do not, inform their judgments. She is particularly critical of the judiciary's unwillingness to enforce covenants not to compete that are designed to protect an employer's often costly investment in the training of its human resources. And she explores alternative approaches courts could employ to protect those investments, concluding that most are, unfortunately, in some way or other flawed or unmanageable.¹

The courts in Indiana are highly suspicious of restrictive employment covenants and will examine them closely to determine whether they are reasonably limited in temporal and geographic scope and whether they seek to protect legally protectible interests in trade secrets, customer lists, or other confidential proprietary information. Indiana courts are loathe to restrain the use of skills or information gained by an employee in the course of his employment.² In other states, Illinois for example, the analysis of whether a particular employer interest is protectible focuses on whether the customer or client relationships for which protection is sought are "near-permanent," which in large part turns on the nature of the business involved.³ Restrictions on future employment, particularly those not included in an employment contract guaranteeing employment for a specified term, are judicially disfavored because they are perceived as lacking in consideration and they operate to restrain the employee from using the skills gained in the course of his employment, thereby constituting a restraint on competition in contravention of the perceived public interest.

Lester is undoubtedly right in characterizing the reasonableness test as frustratingly imprecise.⁴ She is also correct in criticizing the questionable analysis in cases such as *Brunner v. Hand Industries, Inc.*,⁵ which do not adequately take into account the

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1. Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 51-53 (2001).

2. *McGlotham v. Heritage Environmental Services, L.L.C.*, 705 N.E.2d 1069, 1072 (Ind. Ct. App. 1999) (citing *Century Personnel, Inc. v. Brummett*, 499 N.E.2d 1160, 1163 (Ind. Ct. App. 1986)).

3. *E.g.*, *Lawrence & Allen, Inc. v. Cambridge Human Res. Group*, 685 N.E.2d 434, 443-44 (Ill. App. Ct. 1997).

4. Lester, *supra* note 1, at 56-57.

5. 603 N.E.2d 157 (Ind. Ct. App. 1992).

often substantial employer investments in training and the societal benefits of such nonconfidential training.⁶

There are some early signs that the longstanding judicial hostility to covenants may be on the wane, no doubt in part due to the critical analysis of academics, such as Professor Lester, and prominent jurists, such as Judge Richard Posner of the Seventh Circuit. In a decision handed down last year, Posner, in dissent, stated that he sees no reason for continued judicial hostility to restrictive employment covenants, which he views as legitimate methods of protecting an employer's investment in training of its employees.⁷ Posner does not believe the judiciary should continue to scrutinize such covenants to determine whether they serve a "social purpose," an approach he views as inconsistent with the freedom to contract.⁸ He would deny enforcement of restrictive employment covenants only in rare instances, and then only by invoking the doctrines of fraud, duress, or unconscionability in cases of perceived abuses.⁹

My practice is confined to representing labor organizations and individual workers, so I seldom find myself involved in the frequent restrictive covenant disputes involving professionals or more highly compensated managerial or technical employees. Those few occasions when I have encountered restrictive covenants have arisen in the construction industry in which much of my practice is concentrated.

In the construction industry, unions nowadays seek to convince nonunion craft employees to cross over to work for union contractors during periods of tight labor markets, a tactic known as "stripping." Some nonunion contractors have fought back by using restrictive employment covenants. One nonunion contractor, in response to efforts by a union to organize his employees, offered to make his key craftspeople equity owners in a new company he had formed. Each employee would pay \$1000 as an initial capital investment in the new company. The owner agreed to loan any employee the \$1000 initial capital investment, and to forgive the loan after a specified period of time, but only if the employee would agree to sign a covenant not to go to work for any competing contractor for two years after termination. The covenant, which was not included in an employment contract guaranteeing employment for a specified term, also contained a section requiring the worker to pay the contractor's attorney fees in the event the worker brought an unsuccessful enforcement action against him. One can only hope that this use of a restrictive covenant would be doomed by the doctrine of unconscionability or duress.

One novel way unions in the construction trades have used restrictive covenants offensively is by requiring apprentices, prior to their indenturement, to execute what are called Scholarship Loan Agreements ("SLAs"). Under these agreements, apprenticeship programs funded by Taft-Hartley trusts require a would-be apprentice to sign a loan agreement and a promissory note under which he or she agrees to repay

6. Lester, *supra* note 1, at 67-68; see *Curtis 1000, Inc. v. Suess*, 24 F.3d 941, 947 (7th Cir. 1994); see also, Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. LEGAL STUD. 93, 96-97 (1981). However, I believe the court reached the right decision because the covenant was unconscionable and not supported by adequate consideration.

7. *Outsource Int'l, Inc. v. Barton*, 192 F.3d 662, 669-70 (7th Cir. 1999) (Posner, C.J. dissenting).

8. *Id.* at 672.

9. *Id.* at 670-72.

the substantial cost of apprenticeship training, by working for a specified period (usually ten years) only for employers who contribute to the apprenticeship training trust fund. The loan is then reduced proportionately each year the former apprentice, now journeyman, continues to work for signatory contractors. If, following acquisition of journeyman status, the apprentice accepts craft employment with a nonsignatory employer, the apprenticeship trustees are authorized by the SLA to sue for repayment of the balance owed. In 1995, the Seventh Circuit held that such loan agreements are enforceable in federal court under Employee Retirement Income Security Act of 1974.¹⁰ SLAs do not suffer from the infirmities of other restrictive employment covenants, the court held, because they do not prevent the journeyman from working within a geographic area or in a certain industry.¹¹ Instead, they simply impose upon the apprentice an obligation to repay the cost of training if he or she breaches the commitment.¹² The court viewed these agreements as similar to government-financed student loans with compulsory public-service requirements. These agreements have gone far in discouraging the opportunistic recruitment of newly trained journeymen, thereby protecting the industry's investment in this valuable human capital.¹³

Lastly, any attorney practicing in the area of restrictive employment covenants should read District Judge David F. Hamilton's opinion last year in *Bridgestone/Firestone v. Lockhart*.¹⁴ In *Lockhart*, Hamilton not only held a restrictive employment covenant to be overbroad and unenforceable, he also entered judgment in favor of the defendant employee on his counterclaim under the Indiana blacklisting statute¹⁵ and assessed the employer \$50,000 in compensatory damages for attempting, through the device of an overbroad restrictive covenant, to prevent the former employee from obtaining employment with another employer.¹⁶ To my knowledge this decision is the first time that a court in Indiana has found an employer's attempted enforcement of an overbroad restrictive covenant to violate the Indiana statute prohibiting blacklisting, which was passed in the late Nineteenth century when Eugene V. Debs was busily organizing the nation's railway workers.

Turning to Professor Stewart Schwab's discussion on employment law in the future, I acknowledge, as does he, the futility and thanklessness of predicting future trends in the law.¹⁷ The pace of change throughout our society is accelerating almost beyond our ability to comprehend it. Technological and scientific breakthroughs have created whole new industries with a different breed of workers, many of whom have unconventional attitudes about work. However, most workers today have the same concerns, fears, and anxieties that workers have always had. Today, more than ever, workers want training for the skills they will need to compete in the globalized

10. *Milwaukee Area Joint Apprenticeship Training Comm. for the Elec. Indus. v. Howell*, 67 F.3d 1333, 1337 (7th Cir. 1995).

11. *Id.* at 1339.

12. *Id.*

13. *Id.* at 1339-40.

14. 5 F. Supp. 2d 667 (S.D. Ind. 1998); see also Lester, *supra* note 1, at 57 n.37.

15. IND. CODE §§ 22-5-3-2 to -3 (1998).

16. *Lockhart*, 5 F. Supp. 2d 687-88.

17. Stewart J. Schwab, *Predicting the Future of Employment Law: Reflecting or Refracting Market Forces?*, 76 IND. L.J. 29, 29-31 (2001).

economy. They are anxious about the lack of job security. They share an apprehension about the erosion of privacy in their workplaces. Workers, particularly those with families, fret over their inability to find time to nurture their children and to have flexibility to balance the competing demands of family and work. Workers feel an increasing need to become self-sufficient, and yearn for a greater voice in their workplaces.

Like Schwab, I am not optimistic there are significant changes in employment law on the immediate horizon beneficial to the multitude of workers who do not belong to unions or who do not possess high-tech skills or advanced degrees.¹⁸ I would argue that the failure of employment law to keep pace with technological and demographic changes will have long-term deleterious effects not only for workers, but also for the economy as a whole, as talented workers, many of them female, leave a workforce perceived by them as hostile or unsympathetic to their desires for such basics as quality child care and health care.

What are the prospects that workers' concerns will be addressed either by legislative enactment or extension of the common law? Given the fact that Congress and many state legislative bodies are now firmly in the grip of the monied interests and are largely dysfunctional,¹⁹ I am less than optimistic that the next decade will see much in the way of legislation addressing the needs of the next generation of workers. For example, despite the concerns over increasing intrusions upon workers' privacy, Congress was recently unable even to agree on a modest bill providing some substantive protection for the privacy of workers' medical records.²⁰ In Indiana, the only law I am aware of in the past decade which expanded workers' privacy rights was a bill, shepherded through the state legislature by the tobacco industry a few years ago,²¹ which prohibits employers from discharging workers who use tobacco products away from work.²² Efforts to advance privacy interests through novel uses of the common law have fallen victim to the federal judiciary's aggressive invocation of the doctrine of section 301 preemption,²³ where the employees are part of a collective bargaining unit.²⁴ The only significant recent progress in protecting workers' privacy interests has been at the National Labor Relations Board ("NLRB" or "Board"), which in 1997 held that electronic monitoring of union-represented

18. *See id.* at 34, 46-48.

19. *See Soft Money and the Political Parties: Hearing Before the Senate Comm. on Rules and Administration*, 106th Cong. (2000) (statement of Scott Harshberger, President and CEO of Common Cause), 2000 WL 381314 (F.D.C.H.).

20. Health Care PIN Act of 1998, S. 1921, 105th Cong. (1998); *see also* Joyce Friedan, *Medical Records Privacy Bills Mired in Politics*, 30 SKIN & ALLERGY NEWS 53 (June 1999), available at <http://news.medscape.com/IMNG/SkinAllergyNews/1999/v30.n06/san3006.53.01.html>.

21. IND. CODE § 22-5-4-1 to -4. (1998). The assertion that this bill was actually promoted and lobbied for by the tobacco interests is from my personal observations of the General Assembly.

22. *Id.*

23. Labor Management Relations (Taft-Hartley) Act § 301, 29 U.S.C. § 185 (1994).

24. *See, e.g., Brazinski v. Amoco Petroleum Additives Co.*, 6 F.3d 1176, 1179 (7th Cir. 1993).

workers must be bargained over with the employees' collective representative.²⁵ I agree with Schwab that the increase in the number of women in the workforce may be the best hope for changes in employment law.²⁶ This phenomenon was perhaps one of the catalysts for the only significant pro-employee piece of federal employment legislation this decade, the Family and Medical Leave Act of 1993 ("FMLA").²⁷ Demographic changes in the composition of the workforce may portend an eventual expansion of the FMLA to cover many more employers and employees than it currently does, and amendments to provide for paid rather than unpaid time off, as is provided for in similar laws in Europe.²⁸ Recent legislative effort in this regard has focused on allowing workers on FMLA-qualifying leaves of absence to receive unemployment benefits.²⁹ Pressure may also continue to build for a strengthened Equal Pay Act³⁰ to combat the still significant earnings disparity between male and female workers.³¹

With Congress paralyzed and wallowing in the mud of special interest money, the demands of increasingly competitive labor markets are causing some employers to respond to worker needs and concerns in the absence of legislative mandates. Competition for workers is presently so fierce that even bottom-end employers now find it necessary to promise retirement benefits and offer health insurance options in order to attract and keep qualified workers. On the other hand, the competitive labor market has yet to make a dent in the increasing income disparities between rich and poor, or to make any significant inroads into the ever growing number of workers without health insurance. As Frank Levy, an economist at MIT and an author of two books on the income gap recently stated: "Markets are obviously very important in the economy, but they are surrounded by a lot of rules—rules about how easy it is to organize unions and how free trade is—and those rules are determined by the political process, which is now shaped by money [donated to political campaigns]."³²

Schwab observes that employment law can serve as a buffer against the harshest aspects of market forces.³³ But for the foreseeable future, globalization and the increasing influence by the managerial class over legislative bodies will continue to act as a brake on the enactment of employment-law changes which expand worker rights and protections.

25. Colgate-Palmolive Co., 323 N.L.R.B. 515, 516 (1997).

26. See Schwab, *supra* note 17, at 46.

27. 29 U.S.C. §§ 2601-2654 (1994 & Supp. IV 1998).

28. *E.g.*, CHILD CARE, PARENTAL LEAVE, AND THE UNDER 3S: POLICY INNOVATION IN EUROPE, (Sheila B. Kamerman & Alfred J. Kahn eds., 1991).

29. See, *e.g.*, Family Income to Respond to Significant Transitions Insurance Act, H.R. 2500, 106th Cong. (1999).

30. 29 U.S.C. § 206(b) (1994).

31. See, *e.g.*, Lindley H. Clark, Jr., *Speaking of Business: The Pay Gap Narrows—Slowly*, WALL ST. J., July 2, 1993, at A6:4. In a 1991 analysis, Diane Crispell reported that the greatest salary gap between men and women occurs with managerial positions, where women receive only sixty-one percent of the salaries received by men in similar positions. Diane Crispell, *Women's Earnings Gap Is Closing—Slowly*, AM. DEMOGRAPHICS, Feb. 1991, at 14.

32. FRANK LEVY, *THE NEW DOLLARS AND DREAMS* (1998).

33. See Schwab, *supra* note 17, at 33.

