

May 13, 2010

**Restatement Of The Law (Third): Employment Law
Tentative Draft No. 3
(April 8, 2010)**

§ 8.06 Enforcement of Restrictive Covenants in Employment Agreement

**Motion That Monopoly Exception To Enforceability Of Restrictive Covenants
Be Added As Subsection (e) To Section 8.06**

IT IS HEREBY MOVED that the period in line 5, page 46, be changed to a comma, followed by “or,” and that a new subsection (e) be added, so that the line 5 reads

(e) there is no tendency to create, enhance or perpetuate a monopoly.

And that appropriate commentary and reporter’s notes be added to show and explain the legal and policy foundation for the monopoly exception to the enforcement of covenants not to compete currently well recognized in American law.

Statement Supporting The Motion

Contract clauses that restrict a person’s right to compete restrain trade. *See, e.g., Restatement (Second) Of Contracts*, §§ 186(2), 187, 188(1) (1981); *Kennedy v. Metropolitan Life Ins. Co.*, 759 So.2d 362, 364, ¶ 4 (Miss. 2000); *Empiregas, Inc. v. Bain*, 599 So.2d 971, 975 (Miss. 1992). As this is so, there is a “monopoly exception” to the enforceability of covenants not to compete recognized in the case law of many states. *See, e.g., Bruce D. Graham, M.D., P.A. v. Cirocco*, 31 Kan. App. 2d 563, 69 P.2d 194, 196, 199 (2003) (noncompetition covenant effectively froze former employee physician out of Kansas City metropolitan area and gave former employer a monopoly); *Statesville Medical Group v. Dickey*, 106 N.C.App. 669, 673-75, 418 S.E.2d 256, 259-60 (1992) (“enforcing the covenant would grant plaintiff a monopoly for two years, . . .”).

The rationale and policy premise underlying the “monopoly exception” is analogous to the familiar antitrust premise that an ordinary market participant may engage in many practices that become illegal and actionable when engaged in by a firm that has monopoly power [economists seem to prefer “market power”]. Proof of monopoly power is a stand alone exception that trumps all other points that might otherwise justify enforcing a covenant not to compete. The enhancement or perpetuation of monopoly power is not a mere indicia of unreasonableness; any covenant not to compete, the enforcement of which will enhance or perpetuate monopoly power, is *per se* unreasonable.

Where the employer’s monopoly power in geographic and product/service markets is shown, denying enforcement of the covenant is easy. There are practical reasons for extending the “monopoly exception” to cases where the evidence shows only a reasonable tendency towards a monopoly, and not just because “tend” and “tendency” appear in the formulations in

many cases. If the evidence shows a reasonable probability that enforcing the covenant would tend to create a monopoly, what is the policy ground for precluding suit by the departing employee until his former employer has monopoly power? Or for forcing the departing employee to depart the area, to which he will most likely never return? The applicable statute of limitations might well run while the departing employee awaits the tendency toward monopoly to mature? The cost of taking on a monopolist are huge, and most departing employees cannot or will not foot the bill. Among the few who can, many are not willing to put their lives on hold while they litigate with their monopolist former employer. The departing employee's personal autonomy interest and career enhancement interest should be added to the mix, along with the interest of customers/patients to continue to do business with/be served by one who has become a valuable and trusted service/product provider.

An employer's imposing and seeking to enforce a covenant not to compete that fails to satisfy § 8.06 [and § 8.07, and including the monopoly exception I suggest] is actionable "unfair competition" by the employer. *Restatement (Second) Of Contracts*, §§ 186-188 (1981) declares unenforceable such unreasonable restraints on trade. *See also, Restatement Of Contracts*, §§ 518 (1932). Such covenants should be affirmatively declared actionable with remedies recognized [in Chapter 9 yet to come?] where the other grounds of civil liability are shown. Note that effects upon and the interests of the public are important elements of the formulations found in *Restatement (Third) Of Unfair Competition*, § 1 (1995) ("likely effect on both the person seeking relief and the public"); and *Restatement (Second) Of Contracts*, § 186(1) ("grounds of public policy"), 188(1)(b) ("hardship to the promisor and the likely injury to the public") (1981).

Many states recognize the "monopoly exception" by stating a rule to that effect. *Jak Productions, Incorporated v. Wiza*, 986 F.2d 1080, 1085-86 (7th Cir. 1993) (Indiana law) ("If the employer seeks a covenant not to compete solely to restrain competition, it will be struck down because 'it tends to a monopoly,'" citing *Milgram v. Milgram*, 105 Ind. App. 57, 12 N.E.2d 394, 395 (1938); *Humana, Inc. v. Metts*, 571 S.W.2d 622, 626 (Ky. 1978) ("restrictive covenants in restraint of trade are enforceable if they . . . do not have a tendency to unduly restrict competition, or to create monopoly"); *Wilson v. Gamble*, 180 Miss. 499, 510, 177 So. 363, 365 (1937) (covenant enforceable unless "effecting . . . a monopoly"); *Brentlinger Enterprises v. Curran*, 141 Ohio App. 3d 640, 653, 752 N.E.2d 994, 1004-05 (2001) ("where enforcement of a noncompetition clause would result in an employer's having a near monopoly for its products and services in a given market, enforcement may be denied on the grounds that it would harm the public").

Other states instruct that the tendency towards monopoly must be considered. *New Haven Tobacco Company v. Perrelli*, 18 Conn. App. 531, 536, 559 A.2d 715, 718 (1989) ("probability of the restriction's creating a monopoly in the area of trade must be examined"); *Technicolor, Inc. v. Traeger*, 57 Haw. 113, 551 P.2d 163 (1976) ("unless the effect thereof may be substantially to lessen competition or to tend to create a monopoly").

Still other state courts recognize the "monopoly exception," and then, on the facts of the particular case, finding that no monopoly has been shown. *E.g., Marine Contractors Co. v.*

Hurley, 365 Mass. 280, 289, 310 N.E.2d 915, 921 (1974) (no showing that “non-competition agreement . . . would tend to create a monopoly”); *Ruhl v. F. A. Bartlett Tree Expert Co.*, 245 Md. 118, 127-28, 225 A.2d 288, 293 (Md. 1967) (“no danger of a monopoly is apparent”); *Bess v. Bothman*, 257 N.W.2d 791, 795 (Minn. 1977) (no monopoly “since other towing operations were present in the city”); *Empiregas, Inc. v. Bain*, 599 So.2d 971, 975 (Miss. 1992) (“competition in the L.P. gas market in both Kosciusko and Attala County is quite healthy . . . [with] no threat to the public of monopoly or unfair competition”); *Texas Road Boring Co. v. Parker*, 194 So.2d 885, 889 (Miss. 1967) (“no tendency toward the establishment of a monopoly”); *Donahoe v. Tatum*, 242 Miss. 253, 134 So.2d 442, 444 (1961) (no evidence the agreement “tends to promote a monopoly . . . Competition among employment agencies appears to be vigorous.”); *Technical Aid Corporation v. Allen*, 134 N.H. 1, 11, 591 A.2d 262, 267 (1991) (“nor is there any evidence that Technical Aid threatens to accumulate monopoly power”); *Pollack v. Calimag*, 157 Wis.2d 222, 239, 458 N.W.2d 591, 599 (1990) (non-compete agreement did not “create a shortage of workers in the type of service, eliminate competition, or create a monopoly”).

Courts considering claims or defenses of the “monopoly exception” take note of the antitrust backdrop. *Century Circuit, Inc. v. Cardinale*, 1979 WL 3898 fn. 1 (N.Y.Sup. 1979) (“court will not distinguish the requirements of the state and federal statutes for the purposes of this motion”); *Newport Terminals, Inc. v. Sunset Terminals, Inc.*, 279 Or. 93, 109, 566 P.2d 1181, 1189 (1977). There are several reasons why they should do so. For one thing, the rule of § 8.06 in general, and its monopoly exception in particular, overlap with much that is covered by federal and state antitrust law. Lawyers advising clients need to understand the force and effect of the full complex of federal and state statutes and case law in the field.¹ This same complex of federal and state statutes and case law has a similar force and effect on the law being restated. Moreover, antitrust law and practice are more fully developed and afford a rich source of judicial experience in developing concepts and reasoning which may profitably inform [without stifling] the scope and direction of the monopoly exception to covenants not to compete.

Antitrust law accepts the view that an ordinary market participant may engage in many practices that become illegal and actionable when done by a firm that has monopoly power. *See, e.g., U. S. v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-14 (1984); *Eastman Kodak Co. v. Image Technical Serv., Inc.*, 504 U.S. 451, 488-89 (1992) (Scalia, J., dissenting); *U.S. v. Dentsply Int’l*, 399 F.3d 181, 187 (3d Cir. 2005). The Supreme Court has recognized this premise in the context of covenants not to compete.

It is not enough that the agreements may be valid under local law.
Even an otherwise lawful device may be used as a weapon in
restraint of trade or in an effort to monopolize a part of trade or

¹ I have developed this premise rather extensively in my two part article, *The Law Of Business Torts in Mississippi*, 15 Mississippi College L. Rev. 13, 331 (1994/95), beginning at pages 13-16.

commerce. *Agreements not to compete have at times been used for that unlawful purpose.*

Schine Chain Theatres v. U. S., 334 U.S. 110, 119 (1948) (citing cases) [emphasis supplied], cited and quoted in *Newport Terminals, Inc. v. Sunset Terminals, Inc.*, 279 Or. 93, 109, 566 P.2d 1181, 1189 (1977). “Agreements not to compete, with the aim of preserving or extending a monopoly, . . . [are] a violation of the ‘attempt to monopolize’ clause of 2 of the Sherman Act.” *Otter Tail Power Co. v. U. S.*, 410 U.S. 366, 377 (1973). State courts have accepted this premise. *Three Phoenix Company v. Pace Industries, Inc.*, 135 Ariz. 113, 117, 659 P.2d 1258, 1262 (1983) (citing *Otter Tail Power*). Restatement § 8.06 should be grounded in this and other antitrust premises.

The reason why “a monopolist is not free to take certain actions that a company in a competitive (or even oligopolistic) market may take . . . [is that] there is no market constraint on a monopolist’s behavior. See, e.g. *Aspen Skiing*, 472 U.S. at 601-604; *Lepage’s, Inc. v. 3M*, 324 F.3d 141, 151-52 (3d Cir. 2003) (*en banc*). Where a firm has demonstrable monopoly power, it must pursue viable less restrictive alternatives, absent a substantial business justification for not doing so. *Sullivan v. Nat’l Football League*, 34 F.3d 1091, 1103 1st Cir. 1994), *cert. denied* 513 U.S. 1190 (1995); 2A Philip A. Areeda & Herbert J. Hovenkamp, *Antitrust Law* 1505 (2d. ed. 2002); see also *U.S. v. Microsoft*, No. 8-12321998 WL 614485, at *14 (D.D.C. Sept. 14, 1998).

Nevertheless, market participants and at times even professionals, particularly those in the medical profession, often refuse to compete on the merits in the geographic and service/product markets and submarkets in which they participate or to submit themselves to competition on the merits. To the contrary, oftentimes these entities strive for an ever increasing monopoly power, affirmatively engage in anticompetitive and exclusionary practices, impose and enforce anticompetitive restraints on trade, erect unnatural barriers to entry and takes impermissible advantage of natural barriers to entry. Chapter 8 should speak to these by no means infrequent “efforts to maintain [and enhance monopoly] position[s] through means *other than* competition on the merits,” *Microsoft Co. v. U. S.*, 253 F.3d 34, 63 (D.C. Cir. 2001); *Lepage’s, Inc. v. 3M*, 324 F.3d 141, 147 (3d Cir. 2003) (*en banc*) [emphasis supplied].

Respectfully,
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