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Restrictive Covenants (Covenants Not to Compete) – Proposed Legislative Changes to Wisconsin Law

In early March 2015, the Wisconsin Legislature introduced proposed legislation to repeal and recreate Wis. Stat. Sec. 103.465, which governs restrictive covenants (covenants not to compete). Please note that the proposed legislation is still in committee and revisions may be made. The questions and answers below provide general information about changes that may occur if and when the proposed legislation passes and becomes law.

Q: What is the proposed legislation?

A: The proposed legislation, 2015 Senate Bill 69 and 2015 Assembly Bill 91, proposes significant changes to restrictive covenants under Wisconsin law, the enforceability of restrictive covenants under Wisconsin law, and how courts are required to evaluate restrictive covenants in the face of litigation.

Q: Why is the proposed legislation so significant?

A: Under the proposed legislation, Wisconsin law will look far more favorably upon restrictive covenants than under the current law. Currently, Wisconsin law highly disfavors restrictive covenants, and courts interpreting restrictive covenants will narrowly interpret the restrictive covenant against restraint and against the drafter of the restrictive covenant. Under the proposed legislation, however, courts are required to interpret restrictive covenants in favor of protecting reasonable business interests.

Q: What are some of the biggest changes under the proposed new law?

A: Under the current statute, if any portion of a restrictive covenant is too broad in scope or unreasonable, the entire covenant not to compete is rendered void and unenforceable. Under the proposed new law, if a court determines that a restrictive covenant is over broad, over long or does not protect a legitimate business interest, the court can modify the restrictive covenant and only enforce those aspects of the restrictive covenant that are reasonably necessary to protect a legitimate business interest.



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The second biggest change is that, if you are forced to litigate the enforceability of the restrictive covenant, a court may award costs and attorney's fees to the prevailing party.

Q: What types of interests may be protected in a restrictive covenant?

A: A restrictive covenant may protect legitimate business interests, which are defined in the proposed legislation as: 1) a trade secret; (2) other business or professional information that is valuable and confidential to a business or professional practice that is not a trade secret; (3) substantial relationships with specific existing customers, patients, or clients; (4) customer, patient, or client goodwill associated with a specific geographical location; (5) trade names, trademarks, service marks, or trade dress identifying a good or service; and (6) unique, extraordinary, or specialized training that the business provides or obtains.

Q: How long can a restrictive covenant last?

A: There is no specific time limit for a restrictive covenant. However, under the proposed legislation, if the restrictive covenant is effective after the employment relationship ends, a restraint of six (6) months or less from the time of termination is presumed reasonable, and a restraint greater than two (2) years is presumed to be unreasonable. If the consideration for the restrictive covenant was a promise to provide some type of payment or other thing to the restricted party during the term of the restrictive covenant, the court will presume that the restrictive covenant is reasonable.

Q: Can other parties benefit under my restrictive covenant?

A: The proposed legislation provides that a third-party beneficiary may seek enforcement of a restrictive covenant as long as the restrictive covenant both identifies the third-party beneficiary and states that the restrictive covenant is intended to benefit the third-party. If the party seeking enforcement is an assignee or a successor of a party to the restrictive covenant, the restrictive covenant must include a provision authorizing an assignee or successor to enforce the restrictive covenant.



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Q: How do I ensure that my restrictive covenant is enforceable under the proposed new law?

A: A restrictive covenant is enforceable under the proposed legislation if it is reasonably necessary to protect an employer's legitimate business interests, and is reasonable as to time, area, and line of business.

When considering whether a restrictive covenant is reasonable, a court will consider: (1) the duration, scope, and nature of the relationship between the parties prior to the time litigation to enforce the covenant began; (2) the duration, scope, and nature of the potential harm to the legitimate business interests if the restrictive covenant is violated; (3) the conduct of the person against whom enforcement is sought, from the date the restrictive covenant was signed, that is relevant to determine a reasonable duration, scope, and nature of the restraint; and (4) evidence of common practice in regard to nature, scope, and nature of restraint in the industry.

Q: What if a court determines that some aspects of my restrictive covenant are unreasonable?

A: If the restrictive covenant is over broad, over long, or otherwise not reasonably necessary to protect the legitimate business interests of the employer, the court would have the power to modify the restraint and grant only such relief as may be reasonably necessary to protect the legitimate business interest. For example, if a court determined that a 10 mile radius was too broad of a geographic restriction, it could enforce a 5 mile radius without affecting the enforceability of the rest of the restrictive covenant. This is what is referred to as "blue penciling" a covenant not to compete, which is currently disallowed under Wisconsin law.

Q: Would I need to give the employee consideration for a new or modified restrictive covenant?

A: Yes, to be enforceable, an employee must receive consideration for the restrictive covenant. Consideration exists if the parties execute their restrictive covenant at the beginning of the employment relationship. If the restrictive covenant is executed after the beginning of the employment relationship, the new law would recognize that there is



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consideration if the employee receives a payment or other thing of value such as: (1) monetary consideration; (2) a bonus or incentive payment; (3) additional paid time off; (4) access to a bonus or incentive program if the employee would not have otherwise been eligible for such access; (5) continued employment with pay and benefits equal to or greater than prior to the time the restrictive covenant was signed if execution of the agreement is required for continued employment; or (6) a promise that the employer will provide a payment or other thing of value to the employee during the term of the restrictive covenant.

Q: If passed, when would the proposed new law become effective as to my restrictive covenant?

A: The proposed legislation provides that the revised statute will impact only those restrictive covenants entered into, extended, modified, or renewed on or after the date that the new law becomes effective, which is usually the day after it is passed. This means that a restrictive covenant in place prior to the effective date that is **not** extended, modified, or renewed after the effective date would be reviewed under the current law.

Q: If I already have a restrictive covenant, do I need to change it?

A: Because the new law provides for greater enforceability of restrictive covenants, we strongly encourage you to consider extending, modifying, or renewing any restrictive covenant that you entered into with your employees prior to the date upon which the proposed new legislation becomes law.

Q: If I do not currently use restrictive covenants, should I consider using them going forward?

A: Yes, if the law is passed, you should consider implementing restrictive covenants for your key employees, upper management, sales staff, etc., in order to benefit from the greater ease of enforcement under the proposed legislation. Absent the protection of a covenant not to compete, employees are free to compete without restraint, and the effects can be devastating to a business or practice.