The Basics of Employment Based Non-Compete Agreements in Nebraska

by John C. Dunn

When someone calls to discuss restrictive covenants between an employer and employee in Nebraska, there are certain questions and issues that frequently arise and every attorney should be prepared to address. One likely question is: "Are non-competes enforceable in Nebraska?" Another is: "Nebraska will only enforce a non-solicit, right?" Or, perhaps the open-ended request: "What can you tell me about having an employee sign a non-compete in Nebraska?" With these types of questions in mind, this article offers a concise explanation of the basic rules and issues that impact the enforceability of employment-based restrictive covenants under Nebraska law.

This article provides a brief history of employment-based restrictive covenants in Nebraska with a focus on the trends and changes in controlling precedent. It also outlines the standards that govern non-competition and non-solicitation restrictions between an employer and an employee under Nebraska law.

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1. A Brief History of Judicial Decisions Addressing Restrictive Covenants in the Employment Context

In order to understand the current state of Nebraska law regarding employment-based restrictive covenants, a basic understanding of historical precedent is essential. The first reported case in Nebraska involving a restrictive covenant between an employer and employee was in 1924 in *Dow v. Gotch*.[1] In *Dow*, the Nebraska Supreme Court addressed the enforceability of a non-compete agreement between an employee, Ms. Gotch, and her employer, Ms. Dow, which prohibited Ms. Gotch from "engag[ing] in the business of hair or facial treatment" within the City of Grand Island.[2] Following a detailed discussion of the historical approach to restraints of trade, the Court concluded that the restriction was enforceable under the facts of the case.[3] In reaching its conclusion, the Court stated that "the law in the state of Nebraska" is that partial restraints of trade "will be enforced if they are ancillary to a main contract and limited either as to time or space, provided that they are also reasonable in their terms and operation."[4]

After *Dow*, the Nebraska Supreme Court did not provide any meaningful guidance on employment-based restrictive covenants until 1960, when it decided *Securities Acceptance Corp. v. Brown*.[5] In *Securities Acceptance*, the Court described the "three general requirements relating to partial restraints of trade," which continue to guide the analysis of restrictive covenants under Nebraska law:

> First, is the restriction reasonable in the sense that it is not injurious to the public; second, is the restriction reasonable in the sense that it is no greater than is reasonably necessary to protect the employer in

> some legitimate interest; and, third, is the restriction reasonable in the sense that it is not unduly harsh and oppressive on the employee.[6]

Following the *Securities Acceptance* decision, the Court, albeit infrequently, enforced covenants not to compete that were based on industry or occupation and geography.[7] For example, in *Dana F. Cole & Co. v. Byerly*, the Court enforced a non-compete that, in pertinent part, prohibited the employee from being connected with a business that was engaged in the "type of business conducted by the company" within a 75 mile radius of "the city limits of Atkinson, Nebraska."[8] The Court determined that the covenant was reasonably necessary to protect the company's interest in protecting its customer goodwill because the majority of the customers with whom the employee had an opportunity to develop a relationship were located within the 75 mile radius.[9]

The next, and perhaps most, significant development in the law governing employment-based restrictive covenants was the Court's decision in *Polly v. Ray D. Hilderman*.[10] In *Polly*, the Court announced the rule it had "gleaned" from earlier cases in Nebraska, which was that an employment-based non-compete is only enforceable to the extent it "restricts the former employee from working for or soliciting the former employer's clients or accounts with whom the former employee actually did business and has personal contact."[11] In support of this rule, the Court noted that non-competes are only enforceable to the extent they protect an employer from "unfair competition," rather than "ordinary competition."[12] The Court further reasoned that unfair competition arises when an employee "siphons off" the goodwill that the employee may have developed with the employer's customers.[13] Thus, according to the Court in *Polly*, a restriction only protects against unfair competition if it is limited to the customers with whom the employee "actually did business and has personal contact" and any broader restriction is unreasonable and invalid.[14]

The customer-specific rule stated in *Polly* currently governs the enforceability of employment-based restrictive covenants. In fact, whether the restriction uses the phrase customers "with whom the employee did business and had personal contact" has become a threshold issue in determining the enforceability of employment-based restrictive covenants in Nebraska.[15]

2. A Brief Discussion of the Enforceability of Employment-Based Restrictive Covenants Under Nebraska Law

As noted above, Nebraska courts consider three factors in analyzing restrictive covenants between an employer and employee. The factors are whether the restriction is: (1) injurious to the public; (2) no greater than reasonably necessary to protect a legitimate interest of the employer, and (3) unduly harsh and oppressive on the employee.[16] Provided below is a brief analysis of each of these factors; however, courts regularly "start with the second factor before proceeding to the other factors" because the question of whether a restriction is greater than reasonably necessary to protect a legitimate interest is often the key threshold issue in the case.[17] Taking a cue from these courts, the three factors will be discussed in the order of significance rather than numerical order.

a. The restriction must be no greater than reasonably necessary to protect a legitimate interest.

An employer may "have a legitimate interest in protecting its customer goodwill and confidential information."[18] The question of whether a restriction is reasonably necessary to protect a legitimate interest is frequently dispositive as to the enforceability of the restriction. In Nebraska, an employer only has a legitimate interest in protecting itself from "unfair competition" rather than "ordinary competition."[19] As such, any restriction that ventures beyond "unfair competition" into the arena of "ordinary competition" is unenforceable.[20]

i. Customer goodwill.

With respect to customer goodwill, an employer has a protectable interest only in restraining "an employee from working for or soliciting" customers "with whom the former employee actually did business and ha[d] personal contact."[21] With that said, the emphasis on customer-specific restraints has led to a view among some practitioners that only "non-solicitation" restrictions were enforceable in Nebraska.[22] As explained in more detail below, this view is incorrect.

In *Farm Credit Services of America, FLCA v. Mens*, the United States District Court for the District of Nebraska addressed an agreement wherein the employee, Ms. Mens, agreed not to "seek or accept employment with," "call on or solicit the business of, or sell to, or service" any of the customers with whom the employee "actually did business and had personal contact . . . ."[23] In an opinion upholding a Preliminary Injunction, the court rejected the argument that prohibiting Ms. Mens from "seeking or accepting employment with customers" that she "worked with while employed at Farm Credit" was overbroad and unreasonable.[24] In its reasoning, the court pointed to the language that carved out "activities 'unrelated to and not competitive with'" the employer's business.[25] Although the court emphasized this carve out language in response to Ms. Mens' argument, Nebraska precedent indicates that the absence of such carve out language would not have been fatal to the enforceability of the restriction.

In analyzing the scope of restrictions that may be reasonably necessary to protect an employer's customer goodwill, the focus is usually on whether the restriction complies with the "'customer specific' rule."[26] To that point, the Nebraska Supreme Court, in *Polly* and elsewhere, has expressly stated

that a restrictive covenant may prohibit an employee from "working for" customers, as long as the restriction contains the requisite customer-specific language.[27] The Court's use of the phrase "working for" demonstrates that a broad range of activities would be enforceable as long as the restriction was properly customer specific. For example, in *American Security Services, Inc. v. Vodra*, the Court addressed a non-compete prohibiting a former employee, Mr. Vodra, from "solicit[ing] business from, contract[ing] with or tak[ing] employment with" certain customers with whom Mr. Vodra had contact in the course of his employment.[28] The Court concluded that this covenant "was reasonably necessary to protect [the employer's] legitimate business interest in customer good will."[29] In sum, a restriction that prohibits a former employee from working for or accepting employment with a specific customer is consistent with governing precedent.[30]

To clarify one point, the inclusion of a customer-specific restraint in a non-compete does not render the covenant enforceable automatically or as a matter of law. The enforceability of any restriction "must be assessed upon the facts of a particular case and determined on all the circumstances."[31]

ii. Confidential information.

As noted above, an employer has a legitimate interest in protecting its confidential information; however, this interest is frequently discussed only in connection with an employer's customers.[32] Indeed, under current precedent, there is no case where an employer has successfully enforced a non-compete solely on the basis of protecting its confidential information.[33] With that said, in *Kaiser v. Arthur J. Gallagher & Co.*, the United States District Court for the District of Nebraska denied a motion for summary judgment in a declaratory judgment action based on the argument that the non-compete was overbroad because it covered customers about whom the employee "acquired confidential information . . . ."[34] The motion was ultimately denied without prejudice on the grounds that it was not ripe for adjudication, but in its analysis, the court explained that the employee's argument "overlooks [the employer]'s stated need to protect its confidential information" and further noted that "employers 'have a legitimate interest in protecting confidential information.'"[35] Although the court's discussion has no precedential value, it does indicate that under the proper circumstances an employer's interest in protecting confidential information may provide grounds for extending the scope of customers that may be included in a "customer specific" restriction.

b. The restriction must not be injurious to the public.

In many cases, this factor is not disputed and therefore is not discussed.[36] In a case where the employee claims that the restriction is injurious to the public, the court tends to focus on the potential "injury" the public may suffer by being deprived of the employee's services during the restricted period. For example, in *Dow v. Gotch*, the Court concluded that the non-compete did not cause "the city [to] suffer. It had beauty parlors a plenty, a number of them."[37] The manner in which the Court resolved this factor in *Dow* remains instructive on how courts will address the issue today.[38] In any event, there does not appear to be a single reported case in Nebraska where this factor was material to the court's decision.[39]

c. The restriction must not be unduly harsh and oppressive.

The third and final factor, whether the restriction is unduly harsh and oppressive, involves the application of a balancing test in which the court considers a variety of factors ranging from the disparity in bargaining power to whether the employee will be forced to change his or her "calling or residence."[40] In considering these factors, the "harshness and oppressiveness on the covenantor-employee is weighed against protection of a valid business interest of the covenantee-employer."[41]

It is necessary to point out that the applicable balancing was developed in *Philip G. Johnson & Co. v. Salmen*, which was decided prior to *Polly*. Thus, the test was created and initially applied when territorial non-competes were enforceable in Nebraska. Under *Polly*, however, there does not appear to be any reported cases where this factor had a material impact on the enforceability of an otherwise narrowly tailored restriction.[42]

3. Drafting and Other Considerations

In order to properly advise clients and colleagues regarding employment-based restrictive covenants, it is necessary to have a working knowledge of some common pitfalls and practical considerations. In preparing a restrictive covenant, practitioners should be careful to draft the restriction consistent with the customer-specific rule detailed above. If the restriction is found to be greater than reasonably necessary to protect the employer's legitimate interest, the covenant will be thrown out in its entirety and could jeopardize the enforceability of other restrictions.[43] Unlike in many states, Nebraska courts will not reform or "blue pencil" a restrictive covenant on the grounds that "[i]t is not the function of the courts to reform unreasonable covenants not to compete solely for the purpose of making them legally enforceable."[44] In other words, a Nebraska court "must either enforce [a non-compete] as written or not enforce it at all."

Though Nebraska courts' approach to analyzing and enforcing employment-based restrictive covenants can make drafting tedious, the law is nonetheless predictable. As long as practitioners are careful to follow the case law and guidance described above, they can have confidence that the restriction has a reasonable chance of being enforced and, in any event, will not be found unenforceable "on its face."[45]

Endnotes

1 113 Neb. 60, 201 N.W. 655 (1924).

2 *Dow v. Gotch*, 113 Neb. 60, 201 N.W. 655, 656 (1924).

3 Noting its departure from the "old rule", the Court explained that in the past where "[p]eople did not go away from home, they stayed where they were put," but "[t]he situation is different today" where "[m]en and women of all employments go from one end of the country to another . . . people do not remain rooted to their native soil." *Id*.

4 *Id.*

5 *Secs. Acceptance Corp. v. Brown*, 171 Neb. 406, 417, 106 N.W.2d 456, 463 (1960).

6 *Secs. Acceptance*, 171 Neb. at 417, 106 N.W.2d at 463.

7 Riekes, Steven J., *Dead or Alive? Territorial Restriction in Covenants-Not-To-Compete in Nebraska*, 33 Creighton L. Rev. 175, 182 (1999) (correctly noting that "[m]any Nebraska cases have been decided since *Securities Acceptance*, and most Nebraska cases have found the covenant-not-to-compete invalid.")

8 *Dana F. Cole & Co. v. Byerly*, 211 Neb. 903, 905, 320 N.W.2d 916, 918 (1982).

9 *Dana F. Cole*, 211 Neb. at 905, 320 N.W.2d at 918.

10 *Polly v. Ray D. Hilderman & Co.*, 225 Neb. 662 407 N.W.2d 751 (1987).

11 *Polly*, 225 Neb. at 668, 407 N.W.2d at 756 (emphasis added).

12 *Id.* at 665-66, 407 N.W.2d at 755.

13 *Id*.

14 *Id.* at 659, 407 N.W.2d at 756 ("Because the covenant not to compete in this case attempts to restrict Polly from soliciting or working for Hilderman's clients with whom Polly did not work and did not even know, it is greater than is reasonably necessary to protect Hilderman's legitimate interest in customer goodwill, and is thus unreasonable and unenforceable.")

15 *See, e.g, Signature Style, Inc. v. Roseland*, No. 4:19-CV-3089, 2020 WL 58456, at *4 (D. Neb. Jan. 6, 2020) (concluding that the "provision is unenforceable as a matter of law because it does not restrict Roseland from *unfairly* competing by soliciting customers with whom he actually did business, but rather purports to prevent him from competing *at all*.") (emphasis in original). *But see Thrivent Financial for Lutherans v. Hutchinson*, 906 F.Supp.2d 897, 904 (D. Neb. 2012) (enforcing a non-solicitation restriction that applied to clients about whom the employee "had access" to confidential information because the employer had policies in place that limited the employee's access to confidential information to those customers with whom the employee actually worked).

16 *Mertz v. Pharmacists Mut. Ins. Co.*, 261 Neb. 704, 711, 625 N.W.2d 197, 204 (2001).

17 *Farm Credit Servs. of Am., FLCA v. Tifft*, No. 8:18-CV-80, 2019 WL 10894030, at *6 (D. Neb. Dec. 31, 2019). *Accord Gaver v. Schneider's O.K. Tire Co.*, 289 Neb. 491, 499, 856 N.W.2d 121, 127–28 (2014).

18 *Kistco Co. v. Patriot Crane & Rigging, LLC*, No. 8:19-CV-482, 2019 WL 6037416, at *6 (D. Neb. Nov. 14, 2019).

19 *Aon Consulting, Inc. v. Midlands Fin. Benefits, Inc.*, 275 Neb. 642, 653, 748 N.W.2d 626, 638 (2008).

20 *Aon Consulting*, 275 Neb. at 653, 748 N.W.2d at 638.

21 *H & R Block Tax Servs., Inc. v. Circle A Enterprises, Inc.*, 269 Neb. 411, 418, 693 N.W.2d 548, 554 (2005).

22 This misperception is certainly understandable based on the frequency in which customer-specific restrictions are generically referred to as "non-solicitation" restrictions. *See, e.g., W. Point Auto & Truck Ctr., Inc. v. Klitz*, 492 F.Supp.3d 936, 944 (D. Neb. 2020) ("In the employment context, the Nebraska Supreme Court has made it clear that a 'non-compete' provision must be limited to non-solicitation of customers with whom the affected employee had personal contact and actually did business."); *Bryant v. Nationwide Anesthesia Servs., Inc.*, No. 8:21-CV-335, 2021 WL 3912264, at *5 (D. Neb. Sept. 1, 2021) ("Nebraska courts will only enforce an agreement which restricts an employee from soliciting customers with whom the employee had personal contact and with whom the employee did business on behalf of the former employer.")

23 *Farm Credit Servs. of Am., FLCA v. Mens*, 456 F. Supp. 3d 1173, 1178 (D. Neb. 2020).

24 *Farm Credit Servs. of Am., FLCA v. Mens*, No. 8:19CV14, 2019 WL 1013256, at *2 (D. Neb. Mar. 1, 2019).

25 *Mens*, 2019 WL 1013256, at *2.

26 *H & R Block*, 269 Neb. at 418, 693 N.W.2d at 554.

27 *Polly*, 225 Neb. at 668, 407 N.W.2d at 756; *H & R Block*, 269 Neb. at 418, 693 N.W.2d at 554. *See also* WORK, Black's Law Dictionary (11th ed. 2019) (defining "Work" as "[p]hysical and mental exertion to attain an end, esp. as controlled by and for the benefit of an employer . . . .")

28 *Am. Sec. Servs., Inc. v. Vodra*, 222 Neb. 480, 489, 385 N.W.2d 73, 79 (1986) (emphasis added). Although *Vodra* was decided a year before *Polly*, the case was cited approvingly in *Polly* and otherwise remains good law.

29 *Vodra*, 222 Neb. at 489, 385 N.W.2d at 79.

30 *See, e.g., id.* (enforcing restriction that prohibited employee from "tak[ing] employment with" certain customers); *Presto-X-Co. v. Beller*, 253 Neb. 55, 64-65, 568 N.W.2d 235, 240-41 (1997) (stating rule that a covenant may be valid if it "restricts the former employee from working for or soliciting" certain customers) (quoting *Polly*, 225 Neb. at 668, 407 N.W.2d at 756); *Terry D. Whitten, D.D.S., P.C. v. Malcolm*, 249 Neb. 48, 52, 541 N.W.2d 45, 48 (1995) (same). *See also* WORK, Merriam-Webster's Collegiate Dictionary 1442 (11th Ed. 2003) (defining work as "1: activity in which one exerts strength or faculties to do or perform something: . . . the labor, task, or duty that is one's accustomed means of livelihood . . . .")

31 *Vodra*, 222 Neb. at 489, 385 N.W.2d at 79.

[32] *See, e.g.*, *Gaver*, 289 Neb. at 506-07, 856 N.W.2d at 133 (noting that the employee "was not exposed to, and did not acquire, confidential information . . . regarding it's customers or potential customers, such as customer lists."); *Thrivent Financial*, 906 F.Supp.2d at 903-905 (recognizing that employer had a legitimate interest in protecting confidential information, but noting that restriction was enforceable because it only applied to customers with whom the employee's "contact [was] sufficiently close that he developed goodwill with those clients . . . .").

[33] *Mertz*, 261 Neb. at 712, 625 N.W.2d at 204–05 ("As a general rule, 'a covenant not to compete in an employment contract may be valid only if it restricts the former employee from working for or soliciting the former employer's clients or accounts with whom the former employee actually did business and has personal contact.'") (quoting *Professional Bus. Servs. v. Rosno*, 256 Neb. 217, 225-26, 589 N.W.2d 826, 832 (1999)).

[34] *Kaiser v. Arthur J. Gallagher & Co.*, No. 8:17-CV-454, 2018 WL 7958816, at *4 (D. Neb. Mar. 8, 2018).

[35] *Kaiser*, 2018 WL 7958816, at *4.

[36] *See, e.g.*, *Presto-X-Co.*, 253 Neb. at 62, 568 N.W.2d at 239 ("…we cannot conclude from the record that the covenant not to compete was injurious to the public interest. We, therefore, focus our inquiry on whether the covenant protected a legitimate business interest…"); *C & L Indus., Inc. v. Kiviranta*, 13 Neb. App. 604, 698 N.W.2d 240, 247 (2005) ("There is no indication or claim that enforcement of the covenant not to compete in this case will be injurious to the public."); *Kistco*, 2019 WL 6037416, at *6 ("There is no reason to believe the contract is injurious to the public.")

[37] *Dow*, 113 Neb. 60, 201 N.W. at 657.

[38] *See, e.g.*, *Thrivent Financial*, 906 F.Supp.2d at 903-904 (concluding that non-solicitation restriction was "not injurious to the public" because restriction "will only affect a limited segment of the public" and the affected customers "have access to many other financial service firms to obtain financial services.")

[39] The only case the author could find that came close was *Akkad v. Nebraska Heart Inst., P.C.*, No. A-11-572, 2012 WL 1233008, at *8 (Neb. Ct. App. Apr. 10, 2012), where the Court of Appeals of Nebraska noted that "[d]epriving the entire state of Nebraska of the services of a highly specialized physician like Akkad, an interventional cardiologist, is certainly arguably injurious to the public . . . ." However, the fact that the restriction was "arguably injurious to the public" was immaterial to the decision because the court found the restrictions were greater than "necessary to protect the goodwill of NHI . . . ." *Akkad*, 2012 WL 1233008, at *8.

[40] *Tifft*, 2019 WL 10894030, at *6.

[41] *Vodra*, 222 Neb. at 491, 385 N.W.2d at 80.

[42] *See, e.g., id.*; *Kiviranta*, 13 Neb.App. at 615-16, 698 N.W.2d at 250-51; *Tifft*, 2019 WL 10894030, at *6.

[43] *See, e.g., CAE Vanguard, Inc. v. Newman*, 246 Neb. 334, 339, 518 N.W.2d 652, 656 (1994) (adopting the "minority view" under which "courts may not revise an agreement so as to make it enforceable."); *Controlled Rain, Inc. v. Sanders*, No. A-04-858, 2006 WL 1222772, at *12 (Neb. Ct. App. May 9, 2006) (concluding that several textually separate "paragraphs constitute a single, integrated covenant not to compete" and because one paragraph "is invalid, we must conclude that the other paragraph . . . is likewise invalid.")

[44] *Newman*, 246 Neb. at 339, 518 N.W.2d at 655-56 (quoting *Vlasin v. Len Johnson & Co.*, 235 Neb. 450, 455, 455 N.W.2d 772, 776 (1992)). *See also Bryant*, 2021 WL 3912264, at *4 (noting that "Nebraska caselaw has consistently rejected the 'blue pencil' rule . . . .")

[45] *Klitz*, 492 F.Supp.3d at 944 (noting that a Nebraska court will not reform "a covenant that is unenforceable on its face."). *See also Gaver*, 289 Neb. at 509, 856 N.W.2d at 134 (concluding that noncompete was invalid and unenforceable as written).