

### **ESSAY QUESTION NO. 3**

#### **Answer this question in booklet No. 3**

Fishy Wishy Charters, LLC is an Alaska company that operates a charter fishing business in southcentral Alaska. The company's proprietor has created an ultrasonic imaging system that permits company employees to guide the customers to the greatest concentrations of trophy-sized fish in the ocean and rivers in the southcentral Alaska region. All of Fishy Wishy's employees are educated about the unique technology at the start of their employment.

In 2003, Fishy Wishy hired Emily, a young biologist and engineer, as the lead fishing guide for the company's new Flipflop Fishing Excursions. The target market for these trips was female Alaskan Adventure cruise ship passengers. Alaskan Adventure cruise ships depart from Seattle and travel through several ports in southeast Alaska before finally docking in southcentral Alaska for several days. At the end of this rest period, the ships return directly to Seattle.

Emily insisted on having a written employment contract. The parties negotiated a contract that contained this provision:

**NONCOMPETITION.** In the event Emily voluntarily terminates her services as Lead Fishing Guide in breach of this Agreement during the first three years of employment, then for a period of three (3) years after such termination, Emily shall not engage in the charter fishing business, either individually or as an officer, employee, or controlling shareholder of any charter fishing business within the State of Alaska.

Because of the difficulty of determining damages for a breach of this non-competitive clause, the parties agree that, for each day Emily is in violation of this clause, Emily shall pay Fishy Wishy Charters, LLC the sum of One Thousand dollars (\$1,000.00) or the fee for two (2) charter passengers, whichever is less. The parties further agree that this amount represents reasonable compensation to Fishy Wishy for a breach of this clause.

Emily read and signed the employment contract. During the 2003 summer fishing season, Emily used the ultrasonic imaging technology while she was guiding her trips. She began to notice that the trophy fish were always concentrated in areas with particular environmental factors. Emily began using the environmental factors to locate the trophy fish, and used Fishy Wishy's imaging system only as a back-up. By the end of 2005, Emily wanted a break from fishing, and she quit her job at Fishy Wishy to work as an avalanche engineer at a ski area in southeast Alaska.

Before long, Emily realized that she was meant to be a fishing guide. In early 2008, Emily formed her own charter fishing business in southeast (several hundred miles away from the Fishy Wishy charter operation area) and began marketing her services toward female tourists, the vast majority of whom are cruise ship passengers in port for a few days before heading to the next stop on their Alaskan Adventure cruise. Bookings for Fishy Wishy's Flipflop Fishing Excursions trip declined after Emily's charter fishing business began operating.

When Fishy Wishy realized that Emily had opened her own charter fishing business, it sued Emily in Superior Court for breach of the non-competition clause and sought damages under the terms of the contract.

Emily argues that the non-competition clause is unenforceable, and the liquidated damages provision is invalid under Alaska law.

1. Is the non-competition provision between Fishy Wishy and Emily enforceable under Alaska law? Explain.
2. Is the liquidated damages provision in the employment agreement valid? Discuss.

## GRADER'S GUIDE

### \*\*\* QUESTION NO. 3 \*\*\*

#### SUBJECT: CONTRACTS

**1. Is the non-competition provision between Fishy Wishy and Emily enforceable under Alaska law? Explain. (60 points)**

This question tests the examinees' knowledge of the law concerning the enforcement of non-competition clauses in contracts.

The Alaska Supreme Court addressed the enforcement of non-competition agreements in *Metcalf Investments, Inc. v. Garrison*, 919 P.2d 1356 (Alaska 1996) and *Data Management, Inc. v. Greene*, 757 P.2d 62 (Alaska 1988). A non-competition provision will generally be upheld if it is narrowly tailored to reasonably protect the interests of the employer and employee. *Metcalf*, 919 P.2d at 1362. The Alaska Supreme Court has also held that courts can reasonably alter overbroad non-compete covenants to render them enforceable, however, “[a] predicate to the court altering an overbroad covenant not to compete to render it enforceable (based on what restrictions would be reasonable between the parties) is that the overbroad covenant was drafted in good faith.” *Wirum & Cash, Architects v. Cash*, 837 P.2d 692, 709 n.25 (Alaska 1992) (citing *Data Management*, 757 P.2d at 64).

This “reasonableness” approach permits the courts to fashion an agreement between the parties, in accordance with their intention at the time of contracting, and enables the court to evaluate all of the factors comprising “reasonableness” in the context of employee covenants. *Data Management*, 757 P.2d at 65. The factors considered by the court include:

1. The absence or presence of limitations as to time and geography;
2. Whether the employee represents the sole contact with the customer;
3. Whether the employee is possessed with confidential information or trade secrets;
4. Whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition;
5. Whether the covenant seeks to stifle the inherent skill and experience of the employee;
6. Whether the benefit to the employer is disproportional to the detriment of the employee;
7. Whether the covenant operates as a bar to the employee's sole means of support;
8. Whether the employee's talent which the employer seeks to suppress was actually developed during the period of employment; and

9. Whether the forbidden employment is merely incidental to the main employment.

*Id.* at 65 (citations omitted).

In this case, Emily violated the terms of the non-competition provision when she began operating her charter fishing business within three years of her voluntary termination of her employment with Fishy Wishy. Whether the provision is enforceable as written under Alaska law depends on the “reasonableness” of its terms. Consistent with the rule described above, if the provision is deemed reasonable, the court will enforce it as written. If deemed unreasonable, a court may alter the terms to render it reasonable and enforce the modified provision.

1. **Geography.** Fishy Wishy can argue that even though Alaska is a relatively large state, the limitation on doing business throughout the state is reasonable because of the relatively small number of cities and towns located within the state. Tourists, the target market for both Fishy Wishy and Emily, tend to travel to many of these small towns during their vacation, and the two companies would essentially be competing for the same customers. A less restrictive limitation would put Fishy Wishy in direct competition with Emily.

Emily will argue that preventing her from working in the entire state of Alaska is unnecessary and excessive. Fishy Wishy’s business is concentrated in southcentral Alaska, and does not extend to other areas of the state. Emily set up her business in southeast Alaska, several hundred miles from the areas where Fishy Wishy operates. To enforce the geographical restriction on Emily would force her to leave the state if she wanted to continue to be a fishing guide.

**Time.** Fishy Wishy will argue that the three year limitation on participation in the charter fishing business is a reasonable amount of time to protect Fishy Wishy’s interests in its charter operations.

Emily will argue that the three year limitation on participation in the charter fishing business is an unreasonable amount of time to keep Emily from pursuing her career. Each year, many new charter fishing businesses are formed, and will be providing the same type of competition to Fishy Wishy as Emily would be if her business was permitted to continue.

2. **Sole contact with customer.** There are no facts to indicate whether Emily was the sole contact with the customer, or whether Emily’s reputation with customers has affected the success of her business.

- 3. Confidential information or trade secrets.** Fishy Wishy will argue that Emily possesses confidential information regarding the ultrasonic imaging system, the company's advertising techniques, and the company's business model for catering to female customers.

Emily will argue that she is not using the ultrasonic imaging system in her business, and company's advertising techniques or business models do not constitute confidential or trade secret information.

- 4. Eliminate unfair or ordinary competition.** Fishy Wishy will argue that the clause is meant to eliminate unfair competition. The facts intimate that the customer base for both Fishy Wishy and Emily are the Alaskan Adventure cruise passengers, and that by Emily setting up a business at an earlier stop on the cruise route, promising the same services as she acquired at Fishy Wishy, the competition is unfair.

Emily will argue that the clause is invalid because it seeks to eliminate ordinary competition. Because another fishing guide can set up a business similar to Emily's and begin competing against Fishy Wishy, the clause does nothing more than eliminate ordinary competition.

- 5. Stifle inherent skills of employee.** Fishy Wishy will argue that the provision is reasonable because Emily is a young individual with many skills (she is a biologist and engineer), and the provision only remains in effect for three years.

Emily will argue that the provision is unreasonable because being a fishing guide is her chosen profession, and being forced out of that profession for a long period of time is unreasonable.

- 6. Benefit to employer and detriment to employee.** Fishy Wishy will argue that, if the clause is enforced, the benefit to the company and the detriment to Emily will be fairly balanced because the provision is limited in time and only prohibits Emily from working the charter fishing business, not in any other position in her chosen field.

Emily will argue that, if the clause is enforced, Fishy Wishy will receive a disproportional benefit because a portion of its competition will, in effect, be prohibited from competing against it.

- 7. Sole means of support.** The facts established that Emily has the capability of performing other jobs, but she may argue that the fishing business is currently her sole means of support.

**8. Talent developed during employment.** Fishy Wishy has a strong argument that Emily's talents in finding the concentrations of trophy-sized fish was developed during her employment, as a result of her experience with Fishy Wishy's ultrasonic imaging system.

Emily will argue that her talent was developed during her education, not exclusively during the period of her employment, and that anyone could learn the environmental factors that indicate concentrations of large fish may be found nearby.

**9. Forbidden employment incidental to main employment.** The clause only prohibits working in the charter fishing business, and Fishy Wishy will argue that all aspects of that business constitute Emily's "main employment." Further, she can pursue opportunities in the commercial fishing business, etc.

Emily will argue that it is unreasonable to prevent her from owning and operating a charter fishing business, when her main employment with Fishy Wishy was to be a fishing guide.

The facts of this question are close, and a court could easily find that some elements of the non-competition provision are reasonable (*i.e.* the limitation on the time period), but that other elements are unreasonable (*i.e.* the scope of the limitation). To the extent that a court might find certain parts of the provision unreasonable, it can tailor those terms to the reasonable expectations of the parties at the time of contracting and enforce it as modified.

### **Good Faith and Fair Dealing**

It is important to note that a court will not modify a non-competition provision in a contract unless it first finds that the provision was drafted in good faith. *Wirum & Cash*, 837 P.2d at 709 n.25 (citing *Data Management*, 757 P.2d at 64). The covenant of good faith and fair dealing is implied in all contracts as a matter of law. *Alaska Pacific Assurance Co. v. Collins*, 794 P.2d 936, 947 (Alaska 1990). The purpose of the implied covenant is to give effect to the reasonable expectations of the parties, preventing each party from interfering with another party's right to receive the benefits of the agreement. *Hawken Northwest, Inc. v. State, Dep't of Admin.*, 76 P.3d 371, 381 (Alaska 2003). The implied covenant has both a subjective and an objective component. The subjective component prohibits one party from acting to deprive the other of the benefits of the contract. The objective component requires both parties to act in a way that a reasonable person would consider fair. *Id.*

With respect to non-competition provisions in contracts, the Alaska Supreme Court has held that if an overbroad non-compete covenant can be reasonably altered to render it enforceable, then the court should do so, unless it determines that the covenant was not drafted in good faith. *Data Management, Inc. v. Greene*, 757 P.2d 62, 64 (Alaska 1988). The burden of proving that the covenant was drafted in good faith is on the employer. *Id.* See also Restatement (Second) of Contracts § 184(2) (1981) (“A court may treat only part of a term as unenforceable ... if the party who seeks to enforce the term obtained it in good faith and in accordance with reasonable standards of fair dealing.”); UCC § 2-302, codified at AS 45.02.302 (regarding unconscionable contracts or clauses).

The facts do not indicate that the non-compete clause was drafted in bad faith, but examinees may be awarded points for discussing the good faith obligation.

**2. Is the liquidated damages provision in the employment agreement valid? Discuss. (40 points)**

The Alaska Supreme Court has held that, “[g]enerally, parties to a contract are free to stipulate in advance” to an amount that would be paid as compensation for a loss or injury flowing from a breach of the contract. *Carr-Gottstein Properties, Ltd. Partnership v. Benedict*, 72 P.3d 308, 310 (Alaska 2003) (citations omitted). The crucial question regarding enforcement of a liquidated damages clause is whether the stipulated amount is a reasonable pre-contract estimate of actual damages or is an illegal penalty. “A valid liquidated damages clause is an agreement to set in advance the damages for breach which would otherwise be difficult to determine. However, the clause may not set damages so as to penalize the breaching party for the breach, without regard to the harm caused by the breach.” *Helstrom v. North Slope Borough*, 797 P.2d 1192, 1200 (Alaska 1990) (citations omitted).

Alaska has adopted a two-step test for liquidated damage clause enforceability. Liquidated damages are proper (1) where it would be difficult to ascertain actual damages, and (2) where the liquidated amount is a reasonable forecast of the damages likely to occur in the event of a breach. *Carr-Gottstein*, 72 P.3d at 311 (citing Restatement (Second) of Contracts § 356(1) (1981); *Southeast Alaska Constr. Co., Inc. v. State*, 791 P.2d 339, 343 (Alaska 1990)).

The liquidated damages provision at issue here meets the first part of the test, as it would be difficult for the court to ascertain Fishy Wishy’s actual damages due to Emily’s breach of the non-competition provision. The court would otherwise be tasked with determining an appropriate measure of Fishy Wishy’s lost profits, which could be difficult to determine in a charter fishing business that is affected by reputation, weather, and other ephemeral conditions. See *National Bank of Alaska v. J.B.L. & K. of Alaska, Inc.*, 546 P.2d 579, 590

(Alaska 1976) (“The measure for breach of a covenant not to compete is generally not the profits earned by the breaching party, but rather the lost profits of the party asserting the breach.”) (citations omitted).

Whether the liquidated damages provision meets the second part of the test is a close question. Fishy Wishy will argue that, when determining the amount of liquidated damages, the parties attempted to ascertain the approximate damages for a breach of the agreement. Emily will argue that the liquidated damages provision is a penalty provision because it does not realistically approximate damages, and because she will be forced to pay liquidated damages for each day she is in breach of the agreement by operating the business, regardless of whether or not customers patronize her business or the success or failure of her business. *Compare Kalenka v. Taylor*, 896 P.2d 222, 229 (Alaska 1995) *with Carr-Gottstein*, 72 P.3d at 312-13 *and Aviation Associates, Ltd. v. TEMSCO Helicopters, Inc.*, 881 P.2d 1127 (Alaska 1994). Because this is a close question, the examinees’ ultimate conclusions are not as important as the analysis they perform in reaching those conclusions.