

Report From Counsel

Background Report for Winter 2009/2010 Issue

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LITIGATION OVER NONCOMPETE AGREEMENTS

As stated in 54A Am. Jur. 2d Monopolies and Restraints of Trade § 880 (2009),

Covenants not to compete with one's employer after the termination of employment are generally enforceable where they are reasonable, meet contractual prerequisites, and, if regulated by statute, are in compliance with statutory requirements.

Caution: While the courts in states with statutes governing anticompetitive covenants typically utilize a reasonableness analysis either as the statute's express standard for enforceability or in conjunction with application of other statutory criteria, the reasonableness test is not employed in a few jurisdictions whose statutes completely prohibit postemployment covenants not to compete, and it is not used in a state whose statute expressly provides that a covenant's compliance with statutory criteria renders it enforceable without a further showing of reasonableness.

In the majority of jurisdictions, postemployment covenants not to compete, being in partial restraint of trade, are not favored by the law, but, unless the facts and circumstances indicate bad faith on the part of the employer, such covenants are usually enforceable if they are reasonably necessary to protect an employer's legitimate business interests, without imposing undue hardship on the employee. To be enforceable, they may not adversely affect the public interest either. Thus, a postemployment noncompetition covenant is enforceable only if its terms are reasonable with respect to the interests of the employer, the employee, and the public. This three-part inquiry involves consideration of whether the postemployment restrictive covenant is reasonable with respect to time, territory, and the capacity in which the employee is prohibited from competing.

A restraint will be upheld if, considering the parties' situations and the circumstances under which the covenant was made, the restraint appears to have been for a just and honest purpose.

(Footnotes omitted.) See also Elizabeth Williams, Cause of Action

to Enforce Anticompetition Covenant in Employment Contract, 11 Causes of Action 2d 375 (2009).

The employer that was engaged in the distribution of novelty items and sought to impose several different types of restrictive covenants on a former salesperson had only mixed success. Star Direct, Inc. v. Dal Pra, 2009 WI 76, 767 N.W.2d 898 (2009). The employment contract's unenforceable business clause, which prohibited the former employee from engaging in competitive or substantially similar business activities in the former employee's former sales territory, was divisible from the valid customer clause, which prohibited the former employee from soliciting the former employer's current and certain former customers, and from a third provision, also valid, referred to as a confidentiality clause. Under that clause, for 24 months following an employee's termination, the employee was barred from using or disclosing "any information or knowledge, known, disclosed or otherwise obtained by him during his employment." 767 N.W.2d at 903. Thus, the customer and confidentiality clauses were enforceable, although there was substantial overlap among all three clauses; the interests protected by the enforceable clauses were legitimate and separate interests, and the clauses were not textually linked, intertwined, or mutually entangled in any way. Id. at 917.

In Paramount Tax & Accounting, LLC v. H&R Block E. Enters., Inc., 2009 WL 2394796 (Ga. Ct. App. 2009), the fatal flaw in the

noncompete clause was its excessive territorial reach: "Indeed, on its face, this language prevents Squire from accepting employment anywhere in the United States, if her prospective employer engages in the preparation and electronic filing of tax returns and also either has an office or advertises in, or within ten miles of, Block's Gainesville District." Id. at *5. For an extensive collection of cases on this form of restrictive covenant in employment, see C.T. Dreschler, Annotation, Enforceability of Restrictive Covenant, Ancillary to Employment Contract, as Affected by Territorial Extent of Restriction, 43 A.L.R.2d 94 (1955 & Supp. 2009).

TAX BREAKS FOR COLLEGE COSTS

American Opportunity Tax Credit

The Hope Scholarship Credit has been amended and renamed for 2009 and 2010. The new American Opportunity Tax Credit, appearing in 26 U.S.C. § 25A(i), allows up to \$2,500 per student per year for qualified tuition and related expenses for each of the first four years of a student's postsecondary education in a degree or certificate program. The credit rate is 100% for the first \$2,000 of qualified tuition and related expenses, and 25% on the next \$2,000 of qualified tuition and related expenses. The credit phases out for taxpayers with a modified adjusted gross income between \$80,000 and \$90,000 (\$160,000 and \$180,000 for joint

filers). The credit may be claimed against the alternative minimum tax. The modified credit is available for four years of postsecondary education (it was only two years under the Hope Scholarship Credit), and, unlike the Hope Scholarship Credit, the newly named credit is available for course materials (e.g., books), as well as tuition and related fees.

Lifetime Learning Credit

Under the Lifetime Learning Credit, found at 26 U.S.C. § 25A(c), individual taxpayers are allowed to claim a nonrefundable credit against federal income taxes equal to 20% of up to \$10,000 of qualified tuition and related expenses paid during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer. Thus, the maximum allowable Lifetime Learning Credit per year is \$2,000 per taxpayer, regardless of the number of students.

Tuition and Fees Reduction

Pursuant to 26 U.S.C. § 222, individuals are allowed an above-the-line deduction for qualified tuition and related expenses. Expenses qualifying for the deduction are fees paid that are required for the enrollment of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent in a course of instruction at an eligible educational institution. No double deduction is

allowed, so that, if any credits or exclusions are elected, the qualified tuition deduction is not allowed. This deduction is not available for married individuals filing separately.

LENDER MUST RETURN DEBTOR'S VEHICLE

A debtor in a Chapter 13 bankruptcy moved for sanctions for the alleged willful violations of an automatic stay after a secured creditor, which had repossessed the debtor's vehicle prepetition, refused to return the vehicle to the bankruptcy estate due to what it perceived to be the lack of adequate protection of its interests. Thompson v. Gen. Motors Acceptance Corp., 566 F.3d 699 (7th Cir. 2009). A debtor is entitled to actual damages and attorney's fees if he or she is "injured by any willful violation of a stay provided by this section" committed by a creditor. 11 U.S.C. § 362(k)(1).

As a matter of first impression in the Seventh Circuit, the court held that, upon the request of a debtor who has filed for bankruptcy, a creditor must first return an asset in which the debtor has an interest to his or her bankruptcy estate and then, if necessary, seek adequate protection of its interests in bankruptcy court. In so ruling, the Seventh Circuit abrogated some Illinois federal district court decisions, but followed precedents from the Sixth, Eighth, Ninth, and Tenth Circuits. See In re Sharon, 234 B.R. 676 (6th Cir. 1999); In re Knaus, 889 F.2d 773 (8th Cir.

1989); In re Abrams, 127 B.R. 239 (9th Cir. 1991); In re Yates, 332 B.R. 1 (10th Cir. 2005).

Within the meaning of 11 U.S.C. § 362(a)(3), the automatic stay statute, the creditor that had repossessed the vehicle before the bankruptcy petition was filed "exercised control" over the vehicle by refusing to return the vehicle to the bankruptcy estate upon request. A creditor has the burden of requesting adequate protection for its interests, either directly under 11 U.S.C. § 363(e) or by moving for relief from the stay under 11 U.S.C. § 362(d)(1). However, the court reasoned that if a creditor is allowed to retain possession, this burden is rendered meaningless, because a creditor has no incentive to seek protection of an asset of which it already has possession. For the language of 11 U.S.C. § 363(e) to have meaning, Congress must have intended for the asset to be returned to the bankruptcy estate before, not after, the creditor seeks protection of its interests.

MEDICAID BENEFITS AND SPECIAL NEEDS TRUSTS

A permanently disabled Medicaid recipient who resided in a nursing home asserted that a district court erred in rejecting his challenge to State Medicaid Manual (SMM) section 3259.7 [hereinafter SMM 3259.7], an informal rule issued by the Department of Health and Human Services' (HHS) Centers for Medicare and Medicaid Services (CMS). Sai Kwan Wong v. Doar, 571 F.3d 247 (2d

Cir. 2009). SMM 3259.7 requires that, for purposes of determining the benefits due to a Medicaid-eligible individual, states take into account income placed in a Special Needs Trust for that individual's benefit. See 42 U.S.C. § 1396p(d)(4)(A) (defining "Special Needs Trust"). The plaintiff asserted that the district court erred in accepting the defendants' reliance on SMM 3259.7 in calculating his benefits because the rule conflicts with the express language of 42 U.S.C. § 1396p(d), the provision of the Medicaid Act that sets forth Medicaid eligibility rules for trusts created with an individual's assets.

The Second Circuit rejected the plaintiff's reading of § 1396p(d) and instead concluded that Congress did not speak to the question presented. It applied "Skidmore" deference to SMM 3259.7, which was issued by the agency to fill the gap left by Congress. See Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944) (holding that an agency's "rulings, interpretations and opinions" of an act administered by the agency, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance"). The court further ruled that SMM 3259.7 was an appropriate exercise of the agency's authority, and it therefore affirmed the district court's grant of summary judgment to the defendants.

The court in Sai Kwan Wong noted that SMM 3259.7 "has never

faced a serious challenge in either federal or state court." 571 F.3d at 262. It was aware of only one case in which the argument that SMM 3259.7 conflicts with § 1396p(d) had been addressed. See Reames v. Okla. ex rel. Okla. Health Care Auth., 411 F.3d 1164 (10th Cir. 2005). In rejecting the argument, the court in Reames held that SMM 3259.7 "does not conflict with the 'purposes' of federal law" insofar as the rule "provides for full § [1396p](d)(4)(A) protection to all those who would use it to protect income received from sources other than Social Security, and attempts to effectuate both federal law and federal regulation even for that narrow class of disabled individual." Id. at 1171. The court in Sai Kwan Wong further commented that the fact that this aspect of SMM 3259.7 has been challenged so infrequently is further evidence that the validity of the rule is well settled.

GOLFER CAN'T BE SUED FOR ERRANT SHOT

In Anand v. Kapoor, 61 A.D.3d 787, 877 N.Y.S.2d 425 (2d Dep't 2009), an action to recover damages for personal injuries resulting from a golfer's misdirected shot, the trial court granted the defendant golfer's motion for summary judgment. The appellate court affirmed, ruling that (1) the defendant golfer did not owe the plaintiff golfer a duty to give a warning of his intent to hit the golf ball; (2) the plaintiff assumed the risk of being struck by a poorly executed shot; and (3) the defendant golfer's failure

to yell "fore" did not constitute an unreasonably increased risk which the plaintiff did not assume by playing golf.

A defendant unreasonably increases the risks inherent in a sport only where his or her conduct is both without competitive purpose and constitutes a flagrant infraction unrelated to the normal method of playing the game. In Anand, the defendant's allegedly negligent failure to have shouted out a warning before hitting the ball did not constitute such a flagrant and unexpected infraction of a rule.

Although the claim asserted in Anand failed, the results in similar cases nationally are mixed. In a collection of cases covering practically any imaginable scenario in which someone is struck by a golf ball, David M. Holliday, Annotation, Liability to One Struck by Golf Ball, 53 A.L.R.4th 282, § 2[a] (1987 & Supp. 2009), the author summarized the law on this subject, as follows:

It is established that the mere fact that a person is struck by a golf ball driven by one playing a game of golf does not constitute proof of negligence on the part of the golfer who hit the ball, and that a golfer is only required to exercise ordinary care for the safety of persons reasonably within the range of danger of being struck by the ball. Although a golfer about to hit a ball must, in the exercise of ordinary care, give an adequate and timely warning to those who are unaware of his intention to play and who may be endangered by the play, this duty does not extend to those persons who are not in the line of play, if danger to them is not reasonably to be anticipated. Additionally, where a person is in a place where he should be reasonably safe from the danger of being struck by a golfer's shot, and he is aware of the golfer's intention to play, there is no duty to warn since an oral or audible warning would be superfluous.

Recovery for injuries by a person struck by a golf ball may also be barred because the person assumed the risk of injury ordinarily incident to the game of golf, which was obvious or foreseeable. However, one does not assume the risk of being struck by a golf ball as a result of the negligence of another, although recovery may be precluded because of the injured person's contributory negligence.

(Footnotes omitted.)