No. 923175

SUPREME COURT OF THE STATE OF WASHINGTON

Michael Salewski, D.V.M., an individual,
Petitioner,

v.

Pilchuck Veterinary Hospital, Inc., P.S., a Washington corporation
Respondent.

ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

Appellant, Michael Salewski, D.V.M., ("Salewski") seeks review of the Court of Appeals' decision confirming an arbitration award and denying Appellant's Motion to Vacate the Award on July 14, 2014.

At issue is the enforceability of a Confidentiality And Non-Compete Agreement and a liquidated damages clause within the Confidentiality And Non-Compete Agreement. Salewski was employed by Pilchuck Veterinary Hospital, Inc., P.S. ("PVH") and signed various Confidentiality And Non-Compete Agreements between 1992 and 2007 the terms of which varied. Salewski was also a shareholder between 1998 and 2009. Salewski's shares were redeemed pursuant to the terms of a Stock Redemption Agreement dated April 3, 2009 and with an effective date of December 31, 2008. The unpaid redemption amount was reflected in a Promissory Note dated April 3, 2009 (the "Promissory Note). Salewski remained an at-will employee until 2010. The Stock Redemption Agreement signed by Salewski when he sold his shares of PVH provided that the Confidentiality And Non-Competition Agreement from 2007 remained in full effect.

In 2010 Salewski terminated his employment with PVH. Shortly thereafter, PVH learned Salewski had violated, and continued to violate, his Confidentiality And Non-Competition Agreement. PVH stopped making

payments under the Promissory Note for the purchase of his shares. Salewski sued for breach of the Promissory Note. PVH filed a counter claim for breach of the Confidentiality And Non-Competition Agreement and enforcement of the liquidated damages clause. The parties agreed to go to binding arbitration to resolve the Confidentiality And Non-Competition Agreement breach and to determine the enforceability of the liquidated damages clause. The Arbitrator found for PVH on both issues.

In May 2014 PVH moved for Order of Confirmation of Arbitration Award with the Snohomish County Superior Court. Salewski filed a Motion to Vacate the Arbitration Award. On July 14, 2014 Superior Court Judge Richard T. Okrent issued an Order on Motion for Entry of Arbitration Award, Award of Attorney Fees and Costs and Award of Prejudgment Interest and denying Salewski's Motion to Vacate. Salewski filed an appeal on August 7, 2014. On August 31, 2015 the Washington State Court of Appeals Division One confirmed the Arbitration Award and affirmed the Trial Court's judgment against Salewski.

On September 30, 2015 Salewski filed a Petition for Review with this Court.

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II. COUNTERSTATEMENT OF ISSUES PERTAINING TO PETITION FOR REVIEW

PVH denies that the issues raised in Salewski's Petition for Review merit review under RAP 13.4. However, if review were accepted, the issues before this court would be:

A. **Is the mutual promise of all shareholders not to compete adequate consideration for modification of a non-compete agreement?**

B. **Does this case raise issues of substantial public interest that should be decided by this Court to determine if different levels of scrutiny should be applied to non-compete agreements as between business partners and those between employers and employees?**

C. **Is the Court of Appeals decision consistent with this courts rules regarding the reasonableness of liquidated damages provisions when negotiated and agreed to by shareholders of a company and it represents a reasonable forecast of damages for violation of a non-compete agreement?**

III. COUNTER STATEMENT OF THE CASE

A. Factual History

Dr. Salewski began employment with Pilchuck Veterinary Hospital in 1992 as an associate veterinarian. CP 133. On the date of hire Salewski signed a Confidentiality And Non-Competition Agreement. CP 146. In

1998 Salewski signed another Confidentiality And Non-Competition Agreement. CP 146. On or around 1998 Salewski became a shareholder of PVH. CP 147. Each time a new shareholder was brought in to the company each shareholder, including Salewski, signed a new set of employment documents including a Confidentiality And Non-Competition Agreement. CP 147. In 2007 the Confidentiality And Non-Competition Agreement signed by Salewski included a liquidated damages clause of $300,000.00, a fifty mile radius and a three year term limit. CP 147.

In 2008 Salewski wanted to leave the ownership of PVH but remain an at-will employee. CP 147. A Stock Redemption Agreement was executed on December 31, 2008 between Salewski and the remaining shareholders. CP 147. The Agreement provided that the Confidentiality And Non-Competition Agreement signed by Salewski in 2007 would remain in full force and effect. CP 147.

In December 2010 Salewski notified PVH he would leave employment. CP 147. During his exit interview PVH and Salewski discussed the Confidentiality And Non-Competition Agreement. CP 147. Later in 2010 PVH learned Salewski was or had violated the Confidentiality And Non-Competition Agreement. CP 147. Salewski violated the Confidentiality And Non-Competition Agreement by providing veterinary

services within fifty miles of PVH and performing services outside of fifty miles from PVH for previous clients of PVH. CP 147. Upon learning of the breach PVH stopped making payments on the Promissory Note asserting a setoff against Salewski for the liquidated damages clause in the Confidentiality And Non-Competition Agreement. CP 135.

B. Procedural History

On February 23, 2011 Salewski sued PVH in the Snohomish County Superior Court. CP 387-390. PVH counter-claimed for breach of the Confidentiality And Non-Competition Agreement and to enforce the liquidated damages clause. CP 380-382. On June 12, 2012 Salewski's Motion for Summary Judgment was granted on breach of the Promissory Note issue. CP 151-153. PVH's Cross Motion for Summary Judgment was denied. CP 151-152. The parties agreed to arbitrate the enforceability of the Confidentiality And Non-Competition Agreement. The arbitration was conducted on October 23, 2013. CP 146. On November 4, 2013 Honorable Richard J. Thorpe, retired, issued his ruling in the arbitration in favor of PVH. CP 133. Salewski moved for reconsideration which was denied. CP 143-145. On February 25, 2014 the Honorable Richard J. Thorp affirmed his prior ruling and filed the Arbitration Award with the court. CP 146-150.

On May 14, 2014 PVH moved for Entry of Arbitration Award with the Snohomish County Superior Court. CP 132-142. On May 21, 2014 Salewski filed a Motion to Vacate Arbitration Award. CP 114-115. On July 14, 2012 the Honorable Richard T. Okrent heard argument and granted PVH's Order on Motion for Entry of Arbitration Award and denied Salewski's Motion to Vacate. CP. 10-14. On August 7, 2014 Salewski filed his Notice of Appeal. CP 2-9.

On August 31, 2015 the Washington State Court of Appeals Division One confirmed the Arbitration Award and affirmed the Trial Court's judgment against Salewski. *Salewski v. Pilchuck Veterinary Hiospital, Inc., P.S.*, ___ Wn. App. ___, ___ P.3d ___ (August 31, 2015). On September 30, 2015 Salewski filed a Petition for Review.

IV. REASONS WHY REVIEW SHOULD BE DENIED

Salewski seeks review under RAP 13.4(b)(1), claiming that the Court of Appeals' decision conflicts with a decision of this Court, and under RAP 13.4(b)(4), claiming that issues of significant public interest have been raised.

A. The Court of Appeals decision is not in conflict with this Court's decision in *Labriola*

In *Labriola v. Pollard Group, Inc.*, 152 Wn.2d 828, 100 P.3d 791 (2004), this Court held that "independent consideration is required at the

time promises are made for a non-compete agreement when employment has already commenced." In *Labriola*, the employee signed a non-compete agreement upon commencement of his employment. The non-compete clause had no geographic scope. Five years later his employer had him sign a modification of the non-compete agreement limiting the geographic scope to within 75 miles of employer's business. This Court viewed that modification as a new non-compete agreement and held that no adequate consideration was provided because the terms of employment did not change and the employer made no promises to the employee regarding his future employment.

In this case the Court of Appeals found that based on *Ashely v. Lance*, 75 Wn.2d 471, 475, 451 P.2d 916 (1969) the adequacy of the consideration should be viewed in the context of the agreement among owners versus an employee/employer relationship. *Salewski* at ¶ 15 (August 31, 2015) The Court of Appeals found that the series of non-competes signed by Salewski throughout his terms of employment and while a shareholder in the company were a series of modifications of the original non-compete and that "the mutual promises of all of the owners of the business are adequate consideration" for a non-compete agreement among owners. *Salewski* at ¶ 17.

This holding follows *Labriola* in that the Court of Appeals found adequate consideration and therefore upheld the covenant not to compete. In *Labriola* this Court stated that courts generally do not inquire into the adequacy of the consideration but rather the legal sufficiency of the independent consideration given. *Id.* at 834. The consideration for Salewski's modification of the terms of his non-compete was the mutual promise of all shareholders not to compete with the company after their employment was terminated. *Salewski* at ¶ 16-17. This would ensure the business interests and goodwill were protected and allow payment to the departing shareholder under the Company redemption agreement.

The covenants entered into among the doctors/shareholders at PVH were all based upon the presumption and desire of the shareholders that by entering into the covenants not to compete were any one doctor to depart the practice, the remaining doctors could protect their very substantial investment and goodwill in the company. This increased the value of each of their shares and would be paid in the form of a higher share price upon sale or departure from PVH. This equal bargaining power and specific and deliberate negotiation is a broad and fundamental difference from a typical "master-servant" covenant not to compete, and the covenant not to compete in the instant matter is accordingly presumed valid. When the restrictive

covenants were modified it was highly unlikely that any one shareholder imposed his will on the other shareholders knowing who would be the first to leave.

The mutual promises of the shareholders resulting in the increased value of the shares and the protection of their investment and goodwill in the company cannot be viewed as anything other than consideration. Salewski argues that the promises of the other shareholders cannot be consideration for his own promise not to compete and yet, as a shareholder Salewski relied upon this mutual promise to protect his own investment and goodwill. The redemption price of Salewski's shares in PVH reflected the inherent value of the covenant not to compete. It would create unjust enrichment to allow Salewski to have redeemed his shares for full value and then allow him to compete to the detriment of the remaining shareholders.

The *Labriola* decision could be viewed as ambiguous. In *Labriola*, the original non-compete contained no geographic scope and was a blanket prohibition on practice. The second non-compete agreement[1] sought to limit the non-compete to a 75 mile geographic area. This modification was

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[1] Arguably the 2002 non-compete was a mere modification of the 1997 non-compete. The issue would be whether there was consideration for the modification – not consideration for a new non-compete. A plausible argument could be made that the reduction in geographical scope to 75 miles was consideration.

in favor of the employee and without the modification the employee would be barred from any competition with employer, regardless of distance[2]. What the Court did not address in *Labriola* is whether independent consideration is required when an employer seeks to modify a current non-compete agreement in the employee's favor. Employers may be reluctant to modify existing non-compete agreements until this issue is resolved. An employer would be better off attempting to enforce an existing non-compete rather than attempting to bring the non-compete into compliance with evolving case law or, as in the case of *Labriola*, reduce the scope of the non-compete in favor of the employee. This issue may be ripe for consideration.

B. Any issues of substantial public interest have already been decided under *Ashley* and *Labriola*

In *Ashley* the Court recognized that in reviewing a non-compete agreement between partners a different level of scrutiny applied than a non-compete agreement between an employer and employee. 75 Wn.2d at 475. In *Labriola*, this Court held that a modification of a non-compete agreement is enforceable if there was independent consideration at the time of the agreement. *Labriola* also stated that courts do not inquire as to the adequacy

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[2] Such a non-compete would no doubt be unenforceable because of the fact that there was no restriction on geographical scope.

of the consideration but rather the legal sufficiency. Based on the above this Court has affirmatively stated that the mutual promises of shareholder-employees to not compete are adequate consideration for modification of a non-compete agreement.

C. The Court of Appeals decision follows this Courts rules regarding the reasonableness of liquidated damages provisions when negotiated and agreed to by shareholders of a company and represent a reasonable forecast of damages for violation of a non-compete agreement

"[Washington courts] are loathe to interfere with the rights of parties to contract as they please between themselves, and the fact that the parties to a contract call a sum stipulated to be paid in case of breach of the contract liquidated damages is a circumstance to be given serious consideration in determining whether it is in fact liquidated damages." *Management, Inc. v. Schassberger*, 39 Wn.2d 321, 326, 235 P.2d 293 (1951). Liquidated damages clauses are looked at with favor, even in covenant not to compete cases. *Perry v. Moran,* 109 Wn.2d 691, 698, 748 P.2d 224 (1987). Liquidated damages clauses will be enforced if they are reasonable when they are entered into.

The test for enforceability of liquidated damages is (1) the amount fixed must be a reasonable forecast of just compensation for the harm that

is caused by the breach, and (2) the harm must be such that it is incapable or very difficult of ascertainment. *Management, Inc. v. Schassberger*, supra at 327-28; Restatement (Second) of Contracts § 356 (1981)). "The central inquiry is whether the specified liquidated damages were reasonable at the time of contract formation. The reasonableness of liquidated damages is not determined retroactively by their correspondence with actual damages, but by reference to the prospective difficulty of estimating the possible damages that would flow from a breach." *Watson v. Ingram,* 124 Wn.2d 845, 853, 881 P.2d 247 (1994).

The second factor does not play a large role, if any, in covenant not to compete cases because harm resulting to one business from the competition of another business is difficult to estimate accurately as a matter of law. *Mead v. Anton*, 33 Wn.2d 741, 207 P.2d 227 (1949). Liquidated damages provisions are appropriate in covenant not to compete cases because "[t]he harm caused by the breach of a covenant not to compete is very difficult to accurately quantify." *Perry* at 887 (citing *Walter Implement Co. v. Focht*, 107 Wn.2d at 559, 730 P.2d 1340 (1987). (See also, *Perry v. Moran*, on reconsideration).

The shareholders of PVH, from time to time, specifically considered the economic cost to PVH should any of the shareholder employees desire

to leave the practice and compete with his former employer. The amounts derived from these discussions changed occasionally based on the economic circumstances. Concurrent with the discussions of the liquidated damages amount was a discussion regarding the amount or the method of paying for the redemption of a departing shareholder. These are sophisticated business persons who exercised their best business judgment to determine the outcome of their business decisions. Under the business judgment rule a court should not interfere with the business decisions made by a board of directors comprising equal peers. *Scott v. Trans-System, Inc.* 148 Wn.2d 701, 64 P.3d 1 (2003).

The PVH shareholders decided that the best interest of the business and the shareholders were served by a liquidated damages clause in the non-competition agreement. Salewski agreed as a shareholder and expected all other shareholders to abide by the same agreement. Salewski received just compensation for his shares in PVH. Salewski had the choice to abide by the non-competition agreement he freely entered in to or to compete and pay the liquidated damages. The Court of Appeals decision upholding the liquidated damages as reasonable follows this Court's rules on liquidated damages.

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V. CONCLUSION

As a shareholder of the PVH Salewski signed a Confidentiality And Non-Competition Agreement which was modified from time to time and which he reaffirmed when he sold his shares and returned to being an at-will employee. The Court of Appeals held that the mutual promises in a partnership agreement are adequate consideration for a non-competition agreement. Salewski signed the non-competition agreement understanding that all shareholders would be bound by its limitations and consequences and that the promises of the shareholders created value reflected in the redemption prices of the shares. Salewski benefited from this value when his shares were redeemed by PVH.

The liquidated damages clause is enforceable. The courts have held that liquidated damages are suited to a non-competition agreement as actual damages are difficult to quantify. Salewski signed the non-competition agreement with full knowledge as to the consequences as a shareholder of a corporation and intelligent businessman. Salewski did not have to violate the non-competition agreement. Salewski violated the non-competition agreement and in doing so he fully knew that he was subject to the liquidated damages clause.

Salewski's Petition for Review should be denied. The Court of Appeals held that PVH was entitled to attorneys' fees in this matter. PVH hereby requests that the Court award it attorney's fees and costs for preparation and filing of this Answer per RAP 18.1(j).

Dated this 26th day of October, 2015.

Respectfully submitted,

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DECLARATION OF MAILING

Holly Shannon declares as follows:

I am an attorney at Carson Law Group, P.S., a United States citizen, over the age of eighteen (18) years, and am competent to testify to the matters set forth herein.

I certify that on October 26, 2015, I mailed by U.S. First-Class Mail, postage prepaid copies of the above ANSWER TO PETITION FOR REVIEW

to the following:

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I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF WASHINGTON THAT THE FOREGOING IS TRUE AND CORRECT.

Dated at Everett, Washington on October 26th, 2015.

Holly Shannon, WSBA #44957
Attorney for Respondent