VIOLATION OF NON-COMPETE AGREEMENT
NOT SUBJECT TO AUTOMATIC STAY OF BANKRUPTCY COURT
AND NOT DISCHARGEABLE IN BANKRUPTCY

by Marcia S. Cohen

As a general rule, the filing of a bankruptcy petition operates to stay, among other things, the continuation of a judicial proceeding against the debtor that was commenced before the petition. *See* 11 U.S.C. § 362(a)(1). But the automatic stay protection does not apply in all cases; there are statutory exemptions, and there are non-statutory exceptions. The court in which the judicial proceeding is pending has jurisdiction to decide whether the proceeding is subject to the stay. *See NLRB v. Edward Cooper Painting, Inc.*, 804 F.2d 934, 939 (6th Cir. 1986).

Accordingly, a state circuit court has jurisdiction to decide whether an injunction proceeding is subject to the stay, and if not subject to the stay, to enter an injunction against a defendant enjoining her from further violation of the Non-Compete. Most courts, but not all, would agree that the stay applies to damages, but not to injunctive relief.[1]

The leading case is *Dominic's Restaurant of Dayton, Inc. v. Mantia*, 683 F. 3d 757 (6th Cir. 2012). In that case, Plaintiffs brought suit against Defendants for trademark infringement, unfair competition, breach of contract, and fraudulent misrepresentation, among other counts. Plaintiffs sought injunctive relief in their Complaint. After the case was filed, one of the Defendants filed a suggestion of bankruptcy, and claimed that the case was stayed pursuant to the automatic bankruptcy stay. The trial court found that, while the stay applied to the debtor's

[1]One court that disagreed was *Matter of Mahurkar Double Lumen Hemodialysis Catheter Patent Litig.*, 140 B.R. 969, 975 (N.D. Ill. 1992). There Judge Easterbrook, sitting by designation from the Seventh Circuit, rejected arguments espousing an injunction exception to Section 362(a)(1). "Section 362(a) admits of no 'equitable' exceptions".

property, the stay did not apply to protect a debtor's tortious use of that property, citing *Larami Ltd. v. Yes! Entm't. Corp.*, 244 B.R. 56, 60 (D.N.J. 2000). Hence, while the stay would bar an assessment of damages, it would not bar injunctive relief. The Circuit Court of Appeals agreed, reasoning that while the automatic stay provision was intended to prevent interference with a bankruptcy court's orderly disposition of the property of the estate, "it was not intended to preclude post-petition suits to enjoin unlawful conduct." *Dominic's*, 683 F.3d at 760. The *Dominic's* court concluded that "application of the automatic stay would permit [Defendant] to continue to commit this tort. [Defendant's] commission of a tort is not protected by the Bankruptcy Code." *Id.* at 761.

Other courts have ruled similarly. The court in *In re Synergy Development Corp.*, 140 B.R. 958 (Bankr. S.D.N.Y. 1992), stated that, although the automatic stay is one of the most fundamental protections of the bankruptcy code, "bankruptcy does not grant a debtor greater rights than those it would receive outside of bankruptcy", citing *Butner v. United States*, 440 U.S. 48, 55 (1979).

According to the court in *Holland Am. Ins. Co. v. Succession of Roy*, 777 F.2d 992 (5th Cir. 1985), the automatic stay of 11 U.S.C. 362(a)(1) does not extend to claims arising after the filing of the bankruptcy case. "The stay simply does not apply to post-bankruptcy events." *In re Bobroff*, 766 F.2d 797, 803 (3rd Cir. 1985). If violation of a non-compete agreement continues after the debtor files in bankruptcy court, the stay does not apply.

If an action for injunctive relief due to violation of a non-compete agreement is filed in state circuit court before the defendant files his bankruptcy case, and the defendant thereafter seeks to stay the action for injunctive relief, "the court in which the litigation claimed to be

stayed is pending has jurisdiction to determine not only its own jurisdiction but also the more precise question whether the proceeding pending before it is subject to the automatic stay." *In re Glass*, 240 B.R. 782 (Bankr. M.D. Fla. Oct. 25,1999), citing *Erti v. Paine Webber Jackskon & Curtis, Inc. (In re Baldwin-United Corp. Litig.)*, 765 F.2d 343, 347 (2nd Cir. 1985).

In order to determine whether a suit for injunctive relief against the debtor would violate the automatic stay, the court must decide two elements: (1) whether "the estate has a legal or equitable interest in property which would be affected by the suit"; and (2) "whether the requested relief would, in effect, exercise control over that property." *In re Colorado Altitude Training LLC*, No. 10-31951 EEB, 2012 WL 993530, 2 (Bankr. D. Colo. Mar. 23, 2012). Actions that attempt to prevent allegedly unlawful conduct do not constitute "exercise" or "control" over the property of the bankruptcy estate of the debtor within the meaning a 11 U.S.C. § 362(a)(3). *Id.* at 3 (citing *Larami Ltd. v. Yes! Entm't Corp.*, 244 B.R. 56 (D.N.J. 2000).

The *Larami* case is analogous to a non-compete violation case in that there the plaintiff was attempting to prevent future patent infringement and in a non-compete violation case, the Plaintiff wishes to prevent future and on-going competition. The plaintiff in *Larami* did not attempt to directly exercise control over the property of the bankruptcy estate, but merely to prevent continuing unlawful conduct.

Other cases follow the line of reasoning that controlling the future actions of the debtor is different than controlling the property of the debtor. The court in *Amplifier Research Corp. v. Hart*, 144 B.R.693, 694 (E.D. Pa. 1992) ruled on a defamation suit brought against a bankrupt corporation and its president. The *Amplifier* court held that the plaintiff's request for injunctive relief did not attempt to exercise control over the property of the estate, but rather, it only sought

control of the commission of future torts. *Id.* at 695.

In agreement was the court in *In re Colorado Altitude Training LLC*, No. 10-21951 EEB 2012 WL 993530 *2 (Bankr. D. Colo. Mar. 23, 2012). There the court ruled that Section 362(a)(3) was not so broad as to prevent enjoinment of allegedly unlawful post-petition conduct by debtors. Going even further, the court in *E.I. du Pont de Nemours & Co. v. MacDermid Printing Solutions, LLC*, 525 F.3d 1353, 1362 (Fed. Cir. 2008) opined that, even if a lawsuit was commenced before the bankruptcy petition, each individual unlawful act constitutes a separate and discrete cause of action.

In a comprehensive article in The Florida Bar Journal[2], Judge Michael G. Williamson of the Bankruptcy Court, U.S. District Court, Middle District of Florida, Tampa Division, and Attorney Stephanie Crane Lieb explain that the intangible nature of damages stemming from non-compete agreements forces the conclusion that there is no right to payment in cases of violation of non-competes, and therefore no dischargeable claim arises. "In states like Florida that presume irreparable harm where an enforceable non-compete covenant is violated, monetary damages are not a viable option for future violations, and there the ongoing breach cannot give rise to an alternative right to payment as to such future violations. Thus, there can be no claim in bankruptcy for future violations which can only be prevented by injunctive relief." The authors conclude that contractual obligations not to compete fall beyond the outer limits of dischargeability in bankruptcy.

[2]January, 2009, Vol. 83, No. 1.

CONCLUSION

Most courts that have ruled on this issue have held that actions for injunctive relief claiming violations of enforceable non-compete agreements that continue after the petition for bankruptcy has been filed are not subject to the automatic bankruptcy stay and such claims are not dischargeable in bankruptcy.