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LITIGATION OVER NON-COMPETE
AGREEMENTS

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AWARD:

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LITIGATION OVER NON-COMPETE AGREEMENTS

Agreements between employers and their employees prohibiting or restricting competition by a departing employee are nothing new, but their use is growing—and not just for the highest levels of management. This trend makes it all the more important to understand the limits that courts have placed on such agreements, with a view toward balancing employers' interests with policies favoring competition and unfettered opportunities for individuals to pursue their livelihoods. While courts have sometimes struck down non-compete agreements in their entirety, occasionally they effectively have rewritten parts of an agreement, a practice known as “blue penciling,” so as to fix offending parts while retaining acceptable provisions.

In employment contracts, restrictive covenants, as they are sometimes called, are from the outset suspect as restraints of trade that are disfavored at law, and they must withstand close scrutiny as to their reasonableness. For the same reason, they generally are not to be construed to extend beyond their proper import, or farther than the contract language absolutely requires. In cases of ambiguous language, to borrow a term from baseball, the “tie” goes to the former employee. The requirements for enforcing a non-compete agreement may vary some from state to state, but a typical set of conditions requires that the agreement (1) be necessary for the protection of the employer that is, the employer must have a protect-able interest justifying the restriction imposed on the activity of the former employee; (2) provide a reasonable time limit; (3) provide a reasonable territorial limit; (4) not be harsh or oppressive as to the former employee; and, (5) not be contrary to public policy. In keeping with the law's predisposition against such agreements, generally the employer has the burden of proving the reasonableness of a non-compete clause.

In a recent case involving a company that distributed novelty items to convenience stores and similar businesses, a non-compete clause that prohibited a route salesperson from interfering with or attempting to entice away customers—who were customers of the employer during a one-year period before the employee's termination, and whom the employee had serviced, dealt with, or obtained special knowledge about during his employment—was found by a court to be reasonably necessary and enforceable to protect the employer's business. The employer had a legitimate interest in prohibiting solicitation of its recent past customers and in winning back their business, and, as to such customers, the former employee would be in a far better position than an ordinary competitor, with a distinct advantage were it not for the non-compete restriction.

The case of the novelty items business resulted in a split decision for the employer. A separate clause in the agreement, referred to as the “business” clause, prohibited a former employee, for 24 months following his or her termination, from engaging “in any business which is substantially similar to” the employer's business. The court concluded that this provision went too far. It did not protect a legitimate business interest and was thus unenforceable. The engagement of a former employee in a similar, but noncompetitive, enterprise posed little,

if any, additional danger to the employer.

When a tax return preparation firm sued a former employee for breach of a non-compete agreement, the court used a standard providing that an agreement of that kind will be enforced only if the business interests the employer seeks to protect and the effect the covenants have are reasonable as to (1) duration; (2) the capacity in which the former employee is prohibited from competing against his or her former employer; and (3) the geographic territory in which the former employee is restricted from working. The court held that the non-competition clause in the tax preparer's employment contract was over broad for failing to properly limit the territory to which it applied, making the entire covenant unenforceable. The clause purported to limit the former employee from working for any employer whose business included the preparation and electronic filing of income tax returns, if that employer was located, conducted business, or solicited business in the geographic district where the former employee had previously worked or within 10 miles of the district's borders, even if the former employee did not propose to work in or near that district. Such a clause cannot stand, because, as the court put it, it "overprotects" the employer at the expense of a former employee's right to earn a living.

We hope this information is helpful. If you would like more details about these areas or if there are any questions or inquiries concerning this subject matter, please do not hesitate to contact us. Feel free to email us your questions or comments concerning this newsletter.

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