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## COVENANTS NOT TO COMPETE

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## **Covenants Not To Compete**

### **I. OVERVIEW**

#### **A. Preliminary Considerations:**

Post-employment restrictive covenants are enforced differently in all fifty states. Some states, like Colorado, have adopted statutory law directly limiting how covenants are enforced. In Pennsylvania, however, post-employment restrictive covenants are analyzed pursuant to Court-created common law. While Pennsylvania federal and state courts generally agree on broad principles governing restrictive covenants in employment, there are variations between forums which should be noted. Employers should also be aware that Pennsylvania law and theory on this topic has and will continue to evolve.

#### **B. Types of Restrictive Covenants:**

Simply stated, an employee bound by a restrictive covenant agrees to refrain from doing something at the end of his or her employment. Most employment agreements contain multiple restrictive covenants, each pertaining to a specific subject area that the employer wants to protect.

##### **1. Non-Competition Agreements**

Non-competition agreements limit an employee's ability to compete within the employer's industry for a specific period of time following termination of employment. Such covenants are intended to prevent an employee from working for a rival competitor or starting a new business to compete against the former employer. In an economy where jobs are scarce, non-compete agreements are often considered the most stringent of restrictive covenants because enforcement prevents the employee from seeking new employment in an area where he or she usually has significant experience.

##### **2. Non-Solicitation Agreements**

Non-solicitation agreements prevent an employee from persuading customers and suppliers to end their relationship with the employer and join him or her with a rival competitor or new start-up company. Unlike non-competition agreements, non-solicitation agreements do not directly prevent the employee from working for a rival competitor or starting his or her own business. In states that have presumptively banned non-competition agreements, such as California, non-solicitation agreements might still be enforced as an alternative to protect an employer's legitimate interests.

### **3. Non-Disclosure Agreements**

Non-disclosure agreements, also known as confidentiality agreements, are used to prevent employees from exposing trade secrets and other confidential information obtained during the course of employment to third-parties after the employment relationship ends. Although Pennsylvania courts agree that employees owe a fiduciary duty to employers to keep sensitive information learned through employment in confidence, *Lorman v. Lieb*, 37 Pa. D. &C.2d 305, 312-313 (Cam.Pa.Com.Pl. 1965), a non-disclosure agreement further informs the court that the employer had an express legitimate business interest in protecting certain information. Generally, however, an employer will only be able to protect such information that is not easily accessible to the public. Also, employees might be able to defeat a non-disclosure agreement by proving that the trade secret or confidential information was developed or learned prior to the employment relationship.

### **4. Non-Raiding Agreements**

Finally, non-raiding agreements are drafted to prevent an employee from soliciting other employees to join a rival competitor or newly established business. Pennsylvania recognizes a tort, intentional interference with contract relations, which may allow for employers to file suit on other companies and/or former employees for "raiding" their talent base. Adding a non-raiding agreement may strengthen such a cause of action.

## **II. LEGAL BASICS FOR POST-EMPLOYMENT RESTRICTIVE COVENANTS**

### **A. Pennsylvania Standard and Analysis:**

Post-employment restrictive covenants are not favored in Pennsylvania, are historically viewed as a trade restraint that prevents a former employee from earning a living and will be strictly construed. Pennsylvania courts are most likely to enforce post-employment restrictive covenants when (1) ancillary to the employment relationship; (2) supported by adequate consideration; (3) reasonably necessary to protect a legitimate business interest; and (4) limited in both time and territory. *Darius Int'l v. Young*, No. 05-6184, 2008 WL 1820945 (E.D.Pa. April 23, 2008).

After the employer demonstrates a post-employment restrictive covenant exists, Pennsylvania courts usually conduct a balancing test to determine if it should be enforced, weighing the employer's protectable business interests against employee's interest to earn a living, then balancing both interests with what is in the best interests of the public. *PharMethod v. Caserta*, 382 Fed. Appx. 214, 220 (3d Cir. June 2, 2010) (citing *Hess v. Gebhard & Co.*, 808 A.2d 912, 920 (Pa. 2002)).

Courts consider a variety of interests within this balancing test, such as how the employment relationship ended between the employer and employee. Generally, Pennsylvania courts are more reluctant to enforce a post-employment restrictive covenant where the employer

involuntarily terminated the employee. Nevertheless, the Pennsylvania Supreme Court ruled that courts must consider more than how the employment relationship ended when deciding whether to enforce a post-employment covenant. *Misset v. Hub International Pennsylvania, LLC*, 6 A.3d 530, 539-540 (Pa.Super. 2010).

The *Misset* court continued by proposing some factors for future courts to consider in post-employment restrictive covenant cases:

- " What is the situation of employee's family?
- " What is the employee's capacity?
- " Is the employee handicapped or disabled in any way?
- " What effect will the restraint have on an employee's life?
- " Will the restraint deprive an employee's ability to earn a living?
- " Will the employee be forced to abandon his training and education?
- " What is the current economic climate?
- " Is there prevailing unemployment?
- " Was the employment terminable at the employer's will?
- " Did the employee work for an employer for a very brief time?
- " What were the circumstances of the employee's termination?
- " Did termination cause a breach of contract by the employer?
- " Was the employment contract unreasonable?
- " What was the value of consideration to the employee?

These *Misset* factors are not all-inclusive, and a Pennsylvania court may apply different weight to any factor it deems most relevant.

Case Example: In *Colorcon, Inc. v. Lewis*, 792 F.Supp.2d 786, 801 (E.D.Pa. 2011), the Court evaluated the *Misset* factors and ruled that a post-employment restrictive covenant was unenforceable where: (1) there were no other open jobs at her new employer that she was qualified; (2) she would have difficulty finding replacement employment in this economy based on her current education and experience; and (3) her ability to pay back her student loans would be jeopardized. While the employee did receive a \$21,000 severance for signing the covenant, the Court gave that factor only neutral weight because that consideration was also in exchange for agreeing to waive all claims against her former employer.

## **B. Avenues for Enforcement Under Pennsylvania Law:**

An employer has several potential options available in attempting to enforce a post-employment restrictive covenant. First, an employer may ask a Pennsylvania court-in-equity to issue an injunction enjoining the employee from engaging in activities which violate the covenant. An employer seeking a preliminary injunction will need to prove to a court that (1) it is likely to succeed on the merits of the action, (2) that it will suffer irreparable harm in the absence of preliminary relief; (3) that the balance of equities tips in its favor; and (4) that an injunction is in the public interest. *Winter v. Natural Res. Def. Council*, 555 U.S. 7 (2008).

Second, an employer may file a breach of contract action attempting to collect damages. Pennsylvania law may allow an employer to collect a variety of damages in a breach of contract case, such as lost profits; lost customer orders; lost customer goodwill; lost client revenues; costs for development of new trade secrets; loss of converted property; and attorney's fees spent in an attempt to enforce the post-employment restrictive covenant. Employers often choose to utilize both avenues, first attempting to enforce a post-employment restrictive covenant with a preliminary injunction; then filing a breach of contract action to recover any damages suffered as a result of the covenant's violation.

Where a competitor lures away an employee with a post-employment restrictive covenant, the employer may also want to consider filing a tort action against the competitor for tortious interference of contractual relations. To succeed on a claim for tortious interference in a restrictive covenant case, an employer must prove (1) the existence of a contractual or prospective contractual relationship between the employer and employee; (2) purposeful action on the part of the competitor; (3) absence of privilege on the part of the competitor and (4) actual legal damage as a result of the competitor's conduct. *Brown & Brown v. Coca-Cola, Inc.*, 745 F.Supp.2d 588, 621 (E.D.Pa. 2010). In such cases, the post-employment restrictive covenant serves as the contractual relationship needed for the first prong. If the employer can prove actual damages were suffered, then it might be able to recover such damages from the competitor with this cause of action.

### **III. DRAFTING AN EFFECTIVE POST-EMPLOYMENT RESTRICTIVE COVENANT**

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#### **A. Identifying the Client's Objectives:**

When deciding whether to enforce a post-employment restrictive covenant, Pennsylvania courts often begin their inquiry by analyzing what specific business interests the employer hoped to protect by the covenant. Pennsylvania requires post-employment restrictive covenants be drawn only as broad as necessary to protect the legitimate business interests of the employer seeking to enforce the covenant. *Worldwide Auditing Serv., Inc. v. Richter*, 587 A.2d 772, 776 (Pa. Super. 1991). Generally, legitimate business interests may include trade secrets or confidential information; customer good-will; and unique or extraordinary skills and investments developed within an employee-specialized training program. *WellSpan Health v. Bayliss*, 869 A.2d 990, 997 (Pa. Super. Ct. 2005).

Conversely, an employee's aptitude, skills, dexterity, mental ability, and other subjective knowledge obtained during employment will not be considered legitimate business interests in Pennsylvania. Furthermore, a restrictive covenant aimed at fostering a monopoly or oppressing the employee will not be enforced as legitimate interests. See e.g., *Christopher M's Hand Poured Fudge, Inc. v. Hennon*, 699 A.2d 1272, 1275 (Pa.Super.Ct. 1997); *Bell Fuel Corp. v. Cattolico*, 544 A.2d 450, 457 (Pa. Super. 1988).

## **1. Trade Secrets or Confidential Information**

What may qualify as confidential information or trade secrets will vary by industry, however, Pennsylvania courts often use the following six factors when determining whether such interests should be protected: (1) the extent to which the information is known outside of the employer's business; (2) the extent to which the information was known by other employees and third-parties involved in the employer's business; (3) the extent of measures taken by the company to safeguard the secrecy of the information; (4) the value of the information to the company and its competitors; (5) the amount of effort or money the company spent on developing the information; and (6) the ease or difficulty with which the information could be acquired or duplicated. *Bimbo Bakeries USA, Inc. v. Botticella*, 613 F.3d 102, 109 (3rd Cir. 2010).

As examples, sensitive marketing information such as overhead costs, profit-margins, dealer discounts, customer pricing, customer contract terms, unit costs, and inventory data have been considered legitimate business interests to be protected in prior Pennsylvania cases. See *Den-Tal-Ex, Inc. v. Siemens Capital Corp.*, 566 A.2d 1214, 1230 (1989).

## **2. Customer Goodwill**

Customer goodwill, on the other hand, is essentially the employer's reputation. The Pennsylvania Supreme Court formally defines goodwill as "a preexisting relationship arising from a continuous course of business which is expected to continue indefinitely." *Butler v. Butler*, 663 A.2d 148, 152 at n.9 (Pa. 1995). Courts are more likely to value customer goodwill as a salient interest where customers are scarce, suppliers are low, and the industry is in its earliest development stages.

Case Example: Customer goodwill was found to be a very important business interest where the employer's entire business was in the life settlement industry, a new and maturing market where success was based entirely on customer referrals from specific producers and managing agents. *Coventry First, LLC v. Ingrassia*, No. 05-2802, 2005 WL 1625042 (E.D.Pa. July 11, 2005)).

Conversely, Pennsylvania courts are less likely to protect customer goodwill if it is tied significantly to the individual skills of employees or can be attributed to a broad range of factors other than the employer's reputation.

Case Example: Customer goodwill was not found to be a legitimate business interest because it was generated by the individual skills of long-tenured physician-employees and referrals from a third-party, and could not be solely attributable to the employer seeking an injunction. *Wound Care Centers v. Cataline*, No. 10-336, 2011 WL 553875 (W.D.Pa. Feb. 8, 2011)

## **3. Specialized Skill and Training**

As it pertains to specialized skill and training, the employer usually must demonstrate significantly expensive and continuing training; or that the skills in demand were substantially unique to qualify as a legitimate business interest.

Case Example: Employer justified a legitimate business interest in unique skills and training by demonstrating that the employee received personal training on layout and choreography of fireworks displays, gained first-hand experience by participating in aerial fireworks displays, was one of only sixty-eight (68) certified trainers in the United States, and was licensed in Colorado and New York. *Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412, 424-425 (3rd Cir. 2010).

Case Example: Employer could not justify a legitimate business interest in physician employees' unique skills and training where: (1) webcast trainings were offered to all employees and meant as mere "refreshers" (2) they were not referred to when treating patients and (3) training was not of a continuous nature. *Wound Care Centers, Inc. v. Catalane*, No. 10-336, 2011 WL 553875 at \*22.

## **B. Consideration:**

Consideration is the legal definition for value. When determining whether a post-employment restrictive covenant was entered "ancillary" to the employment relationship, Pennsylvania courts examine what value the employee received for signing the covenant. An offer of employment will be sufficient consideration so long as the covenant was signed within a reasonable time after consummating the working relationship. *National Business Services, Inc.*, 2 F.Supp.2d 701, 707 (E.D.Pa. 1998).

Please note, however, that the employee needs to know or have reason to know that the employment offer is conditioned upon the signing a post-employment restrictive covenant before acceptance. Accordingly, it is recommended that the employer include a written statement in a proposed offer letter that employment is conditioned upon the signing of a post-employment restrictive covenant.

Case Examples: No adequate consideration where the employee accepted an offer of employment on November 24, 1996, but had no notice of post-employment restrictive covenants until he was asked by the employer to sign an Executive Agreement on January 17, 1997. *Arthur J. Gallagher & Co. v. Reisinger*, No. 07-271, 2007 WL 1877895 (W.D.Pa. June 29, 2007); but see *Nextgen Healthcare Information Systems, Inc. v. Messier*, No. 05-5230, 2005 WL 3021095 (E.D.Pa. Nov. 10, 2005) (restrictive covenant signed six days after beginning employment was ancillary where employee had notice of restrictive covenant before accepting employment)).

Post-employment restrictive covenants entered into after the employment relationship is established must be supported by new consideration. The promise of continuing employment alone is not valid consideration and the employee must receive some type of corresponding benefit or beneficial change in employment status for the post-employment restrictive covenant to be enforceable.

Case Example: An employee who received a \$2,000.00 raise and was changed from "employment-at-will" to a year-to-year contract base was adequate consideration to enforce a post-employment covenant non-compete. *Insulation Corp of America v. Brobston*, 667 A.2d 729, 733 (Pa.Super. 1995).



When evaluating whether consideration is adequate, Pennsylvania courts often examine the monetary value of consideration; whether the employee received any corresponding increases in responsibility or job-status; whether the consideration offered is truly "extra" and not simply an expected or anticipated salary or benefits increase; and the restrictions of the covenant itself.

Despite the foregoing, two federal court decisions within the Western District of Pennsylvania have held that post-employment restrictive covenants will not fail for lack of consideration so long as the covenant contains an express statement that the employee "intended to be legally bound." See e.g., *Wound Care Centers, Inc v. Catalane*, No. 10-336, 2011 WL 553875 (W.D.Pa. Feb. 8, 2011); *Latuszewski v. Valic Fin. Advisors, Inc.*, No. 03-0540, 2007 WL 4462739 (W.D.Pa. Dec. 19, 2007). Both *Latuszewski* and *Cataline* opined that the Pennsylvania Uniform Written Obligations Act, ("PUWOA") 33 Pa. Con Stat. § 6, provides that such a written statement is a valid substitute for consideration and enforceable against the employee. *Id.* Accordingly, it is recommended that post-employment restrictive covenants include a statement that both parties intend to be legally bound by the terms of the agreement, with or without consideration. Please note, however, that Pennsylvania state courts have not yet opined as to whether PUWOA applies to post-employment restrictive covenants.

### **C. Types of Restrictions:**

Most employment contracts begin with a "scope of work" provision defining what services the employee must provide and what shall be received in return. The scope of work provision might have a significant impact on what can be restricted in a post-employment covenant because it best describes what legitimate business interests the employee will come into contact with during the employment relationship. For example, if it becomes clear that the employee will have frequent contact with customers, then the employer has a significant interest in restricting the employee from contacting those customers after the employment relationship ends. Ambiguity can be fatal, and the practitioner should be careful to investigate what the client needs to protect and draft accordingly.

Case Example: Employee did not violate non-compete agreement by soliciting his prior employer's "former" customers for a competitor because the covenant prevented him soliciting "customers or accounts" of the prior employer. Consulting Black's Law Dictionary, the Court defined the term "customer" as "an entity having a current contractual relationship with a provider for goods or services." The Court further warned that if the employer wanted the covenant to apply to its former customers, "it could easily have worded the provision more broadly and explicitly to ensure that its intent was unambiguous and unmistakable." *Doyle Consulting Group, Inc. v. Stoffel*, No. 2003-02099, 2004 WL 362316 (Pa.Com.Pl. February 13, 2004).

An employee's job description is usually a good source to learn about what interests should be incorporated into the post-employment restrictive covenant for protection. The practitioner should further be well-versed in the client's industry and its relative concerns, such as workforce mobility, identities of possible suppliers and consumers, and possibilities of merger and dissolution.



#### **D. Duration & Geographic Limitations:**

A post-employment restrictive covenant must be limited in time and geographic scope to be enforceable under Pennsylvania law. *Emerson Elec. Co. v. Buffington*, No. 06-1562, 2006 WL 27097580 (E.D.Pa. Sept. 19, 2006). However, it is the employee who bears the heavy burden of persuading a Pennsylvania court that the covenants are unreasonable in time and breadth. *Nat'l Bus. Serv., Inc. v. Wright*, 2 F.Supp.2d 701, 708 (E.D.Pa. 1998).

Pennsylvania courts have not established any set rules dictating when and under what circumstances geographic and time limitations will be overly oppressive upon an employee. In *Vitaulic Co. v. Tieman*, 499 F.3d 227, 237 (3rd Cir. 2007), the Third Circuit Court of Appeals stated that "a per se rule against broad geographic restrictions would seem hopelessly antiquated, and, indeed, Pennsylvania courts . . . have found broad geographic restrictions reasonable so long as they are roughly consonant with the scope of the employee's duties." *Id.*

Usually, Pennsylvania courts will not disturb post-employment restrictive covenants limited to an enforcement period between six months and one year, *American Homecare Supply Mid-Atlantic LLC v. Gannon*, 10 Pa. D. & C. 5th 362 (Pa.Com.Pl. 2009) (Lackawanna)(citing *Boldt Machinery & Tools, Inc v. Wallace*, 366 A.2d 902, 907 (1976)), but have also enforced covenants of two years, or longer, depending on the circumstances. See *Medical Wellness Assoc. P.C. v. Heithaus*, 51 Pa. D. & C.4th 1 (Pa.Com.Pl. 2001) ("Pennsylvania courts have consistently affirmed covenants not to compete for terms between two and three years after employment ends.") (citing *Geisinger Clinic v. DiCuccio*, 606 A.2d 509 (Pa.Super. 1992) (two years against a physician); *Hayes v. Altman*, 225 A.2d 670 (1967) (three years against an optometrist); *Worldwide Auditing Services, Inc. v. Richter*, 587 A.2d 772 (1991) (two years).

As to geographic limitations, Pennsylvania courts will examine whether there is a linear connection between the restriction and the employer's verifiable market size. *Id.* (citing *Sidco Paper Co. v. Aaron*, 351 A.2d 250 (1976)). Non-solicitation covenants, on the other hand, may be enforced without a geographic limit because such provisions prohibit the employee from soliciting those entities which are already customers of the employer; thereby making an extra geographic limitation unnecessarily duplicative. See *Charles Schwab & Co., Inc. v. Karpiak*, No. 06-4010, 2007 WL 136743 (E.D.Pa. January 12, 2007).

Many practitioners incorporate a mileage radius into the restrictive covenant, demonstrating to a court that it took great care to protect only its most important business interests without unfairly impeding the former employee's ability to find new work. Such a strategy, however, can be risky if the radius is based on a physical location that is later sold or closed by the employer.

Case Example: Covenant not to compete could not be enforced because it was based on a physical location which the employer no longer owned or operated. Therefore, enforcement of a 20-mile radius geographic restriction was unreasonable because the employer no longer had a reason to protect its interests in that geographic market. *Wound Care Centers v. Catalane*, 10-336, 2011 WL 553875 at \*23 (W.D.Pa. 2011).

#### **E. Remedies:**

As a preliminary matter, it is recommended that a clause be inserted into an employment contract or post-employment restrictive covenant which provides:

"The Employee agrees that irreparable harm would be suffered by the Employer as a result of a breach of this Agreement and that an award of monetary damages alone for such a breach would be an inadequate remedy. Notwithstanding any other provision in this Agreement, the Employer will have the right, in addition to any other rights it has, to obtain injunctive relief to restrain any breach or threatened breach or otherwise enforce any provision of this Agreement."

The above clause notifies the employee that the employer may use injunctive relief to stop his or her attempts to compete with it after the employment relationship ends. When petitioning a federal court for injunctive relief, however, an employer should understand that it will first need to post security equal to the amount of damages and costs the employee should receive if the employment covenant be found unlawful.

Federal Rule of Civil Procedure 65(c) provides that "the court may issue a preliminary injunction . . . only if the movant gives security in an amount that the court considers proper to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained. The Third Circuit Court of Appeals recently re-affirmed that F.R.C.P. 65(c) is mandatory and that an employer is obligated to post bond for an amount it would need to compensate the employee if he or she ultimately prevails in litigation. *Zambelli Fireworks Manufacturing Co. v. Wood*, 592 F.3d 412, 425-426 (2010).

### **1. Liquidated Damages**

Pennsylvania courts are unlikely to enforce liquidated damages provisions in post-employment restrictive covenants where they are intended to penalize the employee. Pennsylvania law will only enforce liquidated damages provisions where (1) the anticipated damages in case of breach are difficult to ascertain; (2) the parties mutually intend to liquidate their damages in advance; and (3) the amount stated as liquidated damages is reasonable and proportionate to the presumed injury." *AMG Nat'l Trust Bank v. Ries*, No. 09-CV-3061, 2011 WL 6840586 (E.D.Pa. Dec. 29, 2011). In *Ries*, the Court invalidated a liquidated damages provision where the damages that would have been paid by the employee were equal to ten years worth of projected client fees for breaching a two-year post-employment restrictive covenant. *Id.* at \*3.

Conversely, Pennsylvania courts are more likely to enforce liquidated damages clauses when they require the disgorgement of the employee's profits earned during the period after the covenant was violated. For example, in *Omicron Systems, Inc. v. Weiner*, 860 A.2d 554, 564-65 (Pa.Super. 2004), the court awarded the employer liquidated damages in the amount of gross salary paid to the employee during the time frame he was found to have violated the agreement. An employer may also be able to recover lost profits as liquidated damages, so long as the employer can prove actual profits were lost directly because of the employee's breach of the

post-employment restrictive covenant. See *Centrix HR, LLC v. On-Site Staff Management, Inc.*, No. 04-5660, 2008 WL 783558, at \*16 (E.D.Pa. March 25, 2008).

## **2. Forfeiture Clauses**

Forfeiture clauses require the employee to pay back or compensate an employer if choosing to join a competitor or start a new business. Although not favored in Pennsylvania, *Bilec v. Auburn & Assoc., Inc. Pension Trust*, 588 A.2d 538, 543 (Pa. Super. 1991), forfeiture clauses have been enforced where forfeiture was presented as a clear choice for the employee and limited in temporal and geographic scope. For example, in *Fraser v. Nationwide Mut. Ins. Co.*, 334 F.Supp.2d 755 (E.D.Pa. 2004), the Court opined that a forfeiture provision was lawful where it was phrased as an "incentive program" which allowed employees to qualify for a deferred compensation bonus, valued at \$364,000.00, in exchange for agreeing not to compete within 25 miles of the employer for a period of one year. Accordingly, forfeiture clauses are most likely to be enforced when presented as a true choice and not a fait accompli.

## **3. Return of Information**

The employer should expressly state that the employee is to return all pertinent information prior to the end of employment relationship. Such a clause might read, as an example:

"When the employee leaves the employer, the employee will deliver to the employer (and will not keep in his or her possession, copy, recreate or deliver to another) any and all of the employer's tangible and intangible information, including devices, records, data, notes, reports, proposals, lists, correspondence, specifications, drawings, blueprints, sketches, materials, equipment, and other documents or property, together with all copies thereof (in whatever medium recorded) belonging to the employer, its subsidiaries, successors or assigns."

A practitioner should tweak this language following "tangible and intangible" information to protect what specific types of confidential interests the employer expects to protect in a post-employment restrictive covenant. Pursuant to similar language, Pennsylvania courts have granted injunctive relief requiring an employee turn over confidential information discovered to still be in the employee's possession after the end of the employment relationship. See *Hudson Global Resources Holdings, Inc. v. Hill*, No. 07-0132, 2007 WL 1545678 (W.D.Pa. May 25, 2007).

## **F. Severability and Savings Clauses:**

Where a restrictive covenant is overbroad and oppressive but the employer deserves some type of protection, a Pennsylvania court may choose to "blue-pencil", or rewrite the restrictive covenant and enforce as modified to preserve both parties' interests. *PharMethod v. Caserta*, 382 Fed. Appx. 214, 220 (3d Cir. June 2, 2010); (citing *Sidco Paper Co. v. Aaron*, 465 Pa. 576, 351 A.2d 250, 252 (1976)). While severability clauses are customary in contract law, some practitioners also choose to insert a specific blue-pencil provision into their post-employment

restrictive covenant as a compromise if later tested in court. A suggested blue-pencil provision may read:

"If any provision or part of the Agreement is held unenforceable because of any expressed temporal or geographic provision contained therein, the parties hereto agree to modify such provision, or allow a court of due jurisdiction have the power to modify such provision, to reduce the duration or area of such provision or both, or to delete specific words or phrases herefrom (this act be known as "blue-penciling"), and, in its blue-penciled form, shall then be enforceable and shall be enforced."

#### **G. Statutes of Limitation and Tolling:**

Generally, Pennsylvania law provides that actions for tortious interference with contractual relations are subject to a two-year statute of limitations, 42 Pa. Cons. Stat. Ann. §§ 5524(3), and breach of contract actions are subject to a four-year statute of limitations, *Packer Society Hill Travel Agency v. Presbyterian Univ. of Pa. Med. Ctr.*, 635 A.2d 649, 652 (1993) (applied to employment contracts). However, claims under Pennsylvania law do not begin to accrue until the occurrence of the final significant action by the anticipated defendant. *CGB Occupational Therapy, Inc. v. RHA Health Servs. Inc.*, 357 F.3d 375, 384 (3rd Cir. 2004). Nevertheless, the covenant should clearly inform the employee that geographic and temporal restrictions will remain in place and be extended by the duration of any violation.

The practitioner may also consider adding a provision that would limit the time period by which an employee can bring a lawsuit against the employer. At this time, however, it is unclear whether Third Circuit courts would allow parties to contractually reduce the applicable statute of limitations for claims arising out of the employment relationship. The employer in *Carl v. Western-Southern Life Ins. Co.*, No. 09-3990, 2010 WL 3860432 (E.D.Pa. September 30, 2010) raised such an argument where the employment contract barred "any action or suit relating to employment" within a six-month statute of limitations; however, the Court dismissed the case on other grounds. Therefore, such a provision, if added, may not be enforced if a Pennsylvania court finds it to contravene public policy considerations.

#### **H. Choice of Law and Venue:**

As post-employment covenants are enforced differently in all fifty states, adding a choice of venue provision, also known as a forum selection clause, could be vital to the employer. As an example, an employee bringing an employment discrimination lawsuit usually has a broad ability to file his or her civil complaint in a court that may be disadvantageous to the employer. If the employer establishes the presence of a forum selection clause, however, the burden shifts to the employee to demonstrate a strong showing as to why he or she should not be bound to what was agreed to in the post-employment restrictive covenant.

Case Example: Forum selection clause is enforceable where plaintiffs did not contend that their employment agreements were obtained through fraud or overreaching or that they would be deprived of their day in court if the case was transferred. The Court further stated that "forum selection clauses are 'prima facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances . . .by fraud or overreaching, or if the resisting party shows that 'trial in the contractual forum will be so gravely difficult and inconvenient that he will for all practical purposes be deprived of his day in court.'" Neither of these circumstances were presented in this case. *Weight Loss Services LP v. Herbal Magic, Inc.*, No. 11-3859, 2011 WL 4402103 (E.D.Pa. September 22, 2011).

Similarly, Pennsylvania courts will generally honor choice of law provisions in post-employment restrictive covenants so long as the transaction bears a "reasonable relationship" to the state whose law is governing and parties have "sufficient contacts" with the chosen state. For this "reasonable relationship" analysis, courts will be guided by multiple factors, including the place where the covenant was negotiated, the subject matter of the covenant, and the citizenship of both parties. The "sufficient contacts" portion of this inquiry analyzes the quality and quantity of contacts that each party has with the chosen state.

Case Example: Choice of law provision, applying Illinois over Pennsylvania law was enforced because the relationship between Illinois law and the employment contract was sufficient considering that the employer's headquarters, payroll department, primary decision making and location of corporate officers was located in Illinois. The court noted that "[i]n the commercial world, where a company does business in multiple states, it is understandable and reasonable that the company include a choice of law provision in its financial agreements to ensure that those agreements are governed by the laws of its principle place of business." *Britton v. Whittmanhart, Inc.*, No. 09-1593, 2009 WL 2487410 at \*3 (E.D.Pa. August 13, 2009)).

Nevertheless, Pennsylvania courts may refuse to honor choice of law or choice of venue provisions where such run counter to public-policy. In *McIlvaine Trucking, Inc v. W.C.A.B.(States)*, 570 Pa. 662, 810 A.2d 1280 (Pa. 2002), for example, the Pennsylvania Supreme Court refused to enforce a choice-of-law provision because doing so would have prevented an employee from filing a workers compensation for an in-state injury, as against public policy expressed in Pennsylvania's Workers' Compensation Act, 77 Pa. Con. Stat. Ann. § Furthermore, there could be unintended consequences for the employer if the forum or law chosen within the non-compete is applied to other issues and claims that arise from the employment relationship.

Case Examples: Nonresident employee, who was a California citizen and conducted work in of San Diego, was an "employee" under the Pennsylvania Wage Payment and Collection Law and able to bring such a claim against his employer because his employment agreement required the use of Pennsylvania law and made Pennsylvania the exclusive forum for employer-employee disputes. *Synesiou v. DesigntoMarket, Inc.*, No. 01-5358, 2002 WL 501494 (E.D.Pa. April 3, 2002); see also *Crites v. Hoogovens Technical Services, Inc.*, 43 Pa. D. & C.4th 449

(Alleg.Pa.Com.Pl. 2000)) (Ohio resident who operated in Mexico was able to bring a state WPCL claim against his Pennsylvania employer)).

### **I. Attorney Fees:**

Pennsylvania common law generally provides that a successful party in litigation may recover counsel fees and costs only where the opposing party demonstrated bad faith or vexatious conduct." *McMullen v. Kutz*, 985 A.2d 769, 775 (Pa. 2009). Where a restrictive covenant contains a litigation fee-shifting clause, however, Pennsylvania courts are more likely to award attorney's fees to the successful party in litigation as a matter of contract law.

Yet, fee-shifting clauses are narrowly construed and may only be given limited enforcement if oppressive or grossly unfair to the "losing" party. In *Zambelli Fireworks Manufacturing Co. v. Wood*, No. 08-415, 2010 WL 4372357 (W.D.Pa. Nov. 9, 2010), for example, the Court refused to enforce a provision awarding fees to the "prevailing" party where an employer's success on a motion for preliminary injunction to enforce an employment contract was not considered "prevailing" or a final victory in the case. Pennsylvania courts have similarly refused enforcement of fee-shifting provisions where a settlement is reached before litigation comes to a conclusion, *Profit Wise Marketing v. Wiest*, 812 A.2d 1270, 1275-76 (Pa. Super. 2002), or where the "losing" party is at least partly successful on his or her counterclaims. *Boro Const., Inc. v. Ridley School Dist.*, 992 A.2d 208 (Pa.Comwlth 2010)

Fee-shifting provisions are more likely to be enforced when they provide for "reasonable" attorney fees and costs if court intervention is needed to enforce a non-compete. In fact, even if no reasonableness language is contained within the provision, Pennsylvania courts are likely to conduct their own reasonableness inquiry and reduce the potential amount of fees before enforcement. *McMullen v. Kutz*, 603 Pa. 602, 985 A.2d 769, 775 (Pa. 2009).

### **J. At-Will Employment:**

Another important consideration is whether the employee you attempt to bind to a restrictive covenant is considered an employee or independent contractor. In *Figueroa v. Precision Surgical Inc.*, No. 10-449, 423 Fed Appx. 205, 2011 WL 1368778, (3rd Cir. 2010), the Third Circuit, in a non-precedential opinion, found a restrictive covenant to be unenforceable against an independent contractor because the Company treated him like an employee. Mr. Figueroa, titled an Account Executive, had substantial reporting obligations, dress requirements, training mandates, an identification card identifying his affiliation with the Company and sales goals set by the Company. Accordingly, the Court found such factors relevant in determining that the Company breached the restrictive covenant by treating Mr. Figueroa differently than as promised in the employment contract.

As an aside, the Court looks at many factors when determining whether an individual is an employee or independent contractor, such as the nature of the occupation, which party



supplies the "tools of the trade", whether the individual can hold him or herself out as a separate enterprise (i.e. separate business cards), and whether either party has the right to terminate employment at any time. None of the aforementioned factors are dispositive, and the ultimate test is that of "control", i.e. does the Company have control over how an individual performs his or her work.

**K. Assignment:**

In *Hess v. Gebhard & Co.*, 570 Pa. 148, 808 A.2d 912, 922 (2002), the Pennsylvania Supreme Court stated that employment contracts are "personal to the performance of both the employer and employee, the touchstone of which is that trust that each has in the other." *Id.* Following *Hess*, the majority view is that restrictive covenants are not assignable unless there is a specific assignability provision included within the employment agreement. Failure to include an assignability clause is often construed against the employer because, as the drafter of the employment contract, it is often in the best position to include such a clause. See *Allegheny Anesthesiology Assoc. v. Allegheny General Hosp.*, 826 A.2d 886, 892 (Pa.Super. 2003).

Since *Hess*, however, Pennsylvania courts have been more willing to enforce assignment clauses following the employer's sale of equity membership interests, *Misset v. Hub International Pennsylvania, LLC*, 6 A.3d 530, 537-538 (Pa. 2010), or a stock purchase agreement, *Zambelli Fireworks Mfg. Co. v. Wood*, 592 F.3d 412, 418 (3rd Cir. 2010), where neither transaction changed the true identity of the employer or the employee's obligations under the covenant. More recently, the Third Circuit opined that Pennsylvania courts are to determine (1) the relationship between the assignee and assignor, i.e. are they wholly unrelated; (2) whether there was an assignment as a matter of fact, and (3) whether the employee's personal relationship and performance to the employer changed following the assignment. *Pharmethod, Inc. v. Caserta*, 382 Fed.Appx. 214, 219 (3rd Cir. 2010).

Following *Pharmethod*, it is recommended that the practitioner continue to insert an assignability clause within the post-employment restrictive covenant for the employer's protection. Such an assignment clause should prohibit the employee from transferring his or her obligations under the agreement, while preserving the employer's ability to transfer the covenant to a third-party. Nevertheless, the employer should be aware that, applying *Hess*, it is possible that the covenant might not be enforceable after a significant merger or dissolution of the company.





Michael R. Miller represents a variety of clients in Labor and Employment Law, Civil Rights Liability, Municipal Law, Education Law and General Liability matters.

Michael has litigated on behalf of both employers and employees in numerous areas of Labor and Employment law, including public and private sector labor relations; gender, racial, disability, age, and sexual orientation harassment and discrimination; workplace violence; employee drug abuse policies; employment contracts; wage payment; Family Medical Leave Act; WARN; and employee benefit issues. He has given expert lectures on the enforceability of employment contracts and employee handbooks under Pennsylvania law. Part of his practice also involves employer counseling, advising how to spot and remedy potential workplace issues before such become the subject of litigation.