

EMPLOYMENT & IMMIGRATION LAW

Enforceable Non-Compete Agreements: How Employers Can Adequately Define and Protect Their Legitimate Business Interests

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Today, downsizing and the reality of transient employment relationships have forced employers to protect their economic interests. The departure of well-trained, highly productive employees creates a potential threat to business. Employees often have significant knowledge of the company, which they could share with a competitor or use to start their own business and directly compete. To defend their business, and not jeopardize continued, long-term success, one valuable approach is to have employees sign non-compete agreements (“non-compete”). In the employment context, a non-compete is usually part of an employment agreement where the employee agrees for a specific period of time and within a particular geographic area to refrain from competition with the business owner. *Black’s Law Dictionary*, 364 (6th ed. 1990).

When improperly drafted however, non-competes can be the subject of legal attack, thereby offering little or no protection. Consequently, it is vital that employers be familiar with how to create an enforceable non-compete. Because of the proximity of New Jersey to other

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states such as New York, Pennsylvania and Delaware, employers are frequently faced with drafting a non-compete that may need to be enforced in several states. Employers should understand the similarities and differences in how these states define, execute and enforce non-competes.

To insure enforceability, employers must balance the necessity of protecting their legitimate business interest with the fair interests of the employee. Each agreement should be judged independently, paying close consideration to the status of the business, the employees involved, the interests of the business to be protected, and the laws of the state interpreting and enforcing the agreement.

The Necessity of a Protectible Business Interest

In general, contract law governs enforceable non-competes. Non-competes should contain the following provisions: (1) a “noncompetition” provision, which prevents a previous employee from engaging in an activity that may, or does, compete with their previous employer; (2) a “non-solicitation” provision, which restricts the employee from soliciting customers and/or prospects and the employer’s other employees; (3) a “nondisclosure” or “confidentiality” provision, which limits an employee’s unauthorized use of confidential company, proprietary, or trade

secret information; (4) a “choice-of-law” provision defining which state’s law will be used to interpret the agreement; (5) a venue/forum selection provision that specifies where the parties will litigate or arbitrate a breach of the non-compete; and (6) an “attorney fee” provision indicating which party is responsible for attorney fees, costs and expenses.

The law values free mobility of employees as well as open and fair competition. Accordingly, some courts disfavor non-competes. Nevertheless, courts will enforce a non-compete if it is reasonable and protects an employer’s legitimate business interest.

New Jersey protects as legitimate business interest, trade secrets, confidential business information, employer good will and customer relationships. Moreover, these states will not enforce a non-compete entered into solely to restrict competition.

Enforcement of a Non-compete

Once these courts recognize a legitimate business interest, enforceability depends on state-specific law. New Jersey courts have held that the test for determining whether a non-compete is unreasonable, and thus unenforceable, requires the court to determine “whether (1) the non-compete was necessary to protect the employer’s legitimate interests in enforcement, (2) whether it would cause undue

hardship to the employee, and (3) whether it would be injurious to the public." *Solari Indus. v. Malady*, 55 N.J. 571, 576 (1970). Similarly, New York courts have held that non-competes in employment contracts will be enforced to the extent necessary to protect the employer if the non-compete is reasonably limited in time and scope. *Contempo Communications, Inc. v. MJM Creative Services, Inc.*, 182 A.D.2d 351, 353 (N.Y.A.D. 1992).

Employers should recognize that these courts generally enforce a non-compete only if it is reasonable and protects an employer's legitimate business interest. The prudent employer will understand that these courts scrutinize non-competes to determine whether: (1) the employer has a legitimate interest in being protected from the competition of the employee; (2) the agreement is reasonable in light of all the circumstances; (3) the agreement is reasonably limited in time, scope, and geography; and (4) will enforcement of the agreement prove harmful or unduly burdensome to the public. *In-Flight Newspapers, Inc. v. Magazines In-Flight, LLC*, 990 F. Supp. 119 (E.D.N.Y. 1997). Additionally, employers should consider: (1) the employee's ability and intent to compete; (2) the employee's relationships and contacts with those who have expertise in the business; and (3) the employee's relationships and contacts with customers. *Platinum Management, Inc. v. Dahms*, 666 A.2d 1028 (N.J. Super. Ct. Law Div. 1995).

Necessity of Consideration in Non-competes

Non-competes are generally part of an employment agreement, consequently, there should be adequate consideration. New Jersey, Pennsylvania and Delaware all hold that the signing of a non-compete at the inception of employment is sufficient consideration. New York, while not speaking directly on the issue, appears to also enforce non-competes signed at the inception of the employment relationship.

After the employment relationship has begun, and the employer requires the employee to sign a non-compete, however, the necessity of consideration becomes more important. Pennsylvania and Delaware

agree that a positive change (promotion or change in compensation) in the employee's position in exchange for the signing of the non-compete is sufficient. New Jersey and New York have not addressed this issue directly but have enforced non-competes entered into after employment has commenced.

In New Jersey, New York and Delaware, continued employment is sufficient consideration for an enforceable non-compete. In Pennsylvania, however, the Pennsylvania Uniform Written Obligations Act ("UWOA") obviates the need for new consideration for a non-compete entered into after the employment relationship had begun, so long as the non-compete states that the parties intend to "be legally bound." Notwithstanding the UWOA, Pennsylvania courts have held that the mere continuation of employment is not sufficient consideration to support a non-compete entered into after the employment relationship has begun. *Wincup Holdings, Inc. v. Hernandez*, 2004 WL 953400 (E.D. Pa. May 3, 2004). Further, Pennsylvania requires adequate and sufficient consideration.

Attorney's Fees in Non-competes

As noted, non-competes are generally part of an employment contract. Therefore, assuming the employee has breached a valid contract between the employer and employee and the contract contains a non-compete clause with an attorney fee provision, the attorney's fee provision may be enforced. In *Pierson v. Medical Health Centers, P.A.*, 183 N.J. 65, 70 (N.J. 2005), the New Jersey Supreme Court upheld an arbitrator's award of \$75,000 in attorney's fees. The Court noted that New Jersey adhere[s] to the case-by-case approach for determining whether a restrictive covenant in a post-employment contract is unreasonable and unenforceable. Similarly, New York notes that "[c]ounsel fees are not recoverable in an action unless specifically provided for by statute or contract." *Wright v. Selle*, 27 A.D.3d 1065, 1067 (N.Y.A.D. 4 Dept. 2006). Likewise, Pennsylvania will enforce a provision awarding attorney fees to the prevailing party. *Profit Wize Marketing v. Wiest*, 812 A.2d 1270 (Pa.

Super. 2002). Equally, in Delaware, in the absence of statute or contract, a litigant must pay his own counsel fees. *In re Equitable Trust Co.*, Del.Ch., 30 A.2d 271 (Del. Ch. 1943). To recover attorney fees, costs and expenses, an employer must include an attorney fee provision in the non-compete.

Blue Pencil

These courts will apply the "blue pencil" rule if a non-compete has unreasonable provisions. Under this approach, courts will strike or modify overbroad or vague provisions from the agreement and enforce the other terms.

New Jersey courts blue-pencil and will limit or modify a non-compete in duration, geographical area or scope of activity. *The Community Hospital Group, Inc. v. More*, 869 A.2d 884 (N.J. 2005). New York blue-pencils those terms unnecessary to protect the former employer's legitimate interest. *Greystone Staffing, Inc. v. Goehringer*, 836 N.Y.S.2d 485 (Sup. Ct. Nassau Cty. 2006). Pennsylvania blue-pencil to protect the employer and removes unreasonable terms where a non-compete imposes restrictions broader than necessary. *Hess v. Gebhard & Co., Inc.*, 808 A.2d 912 (Pa. 2002). Delaware courts blue-pencil and enforce a non-compete to the extent it is reasonable to do so. *Pollard v. Autotote, Ltd.*, 852 F.2d 67 (3d Cir. 1988).

In today's business climate, employers must look for any advantage to separate them from, and protect against, the competition. A properly executed non-compete is an integral document to protect the business interests of the company. Employers, given the disparate law in different states, would be wise to insure that all non-competes are supported by adequate consideration, are specifically tailored to each employee, protect a legitimate interest of the company and are not anticompetitive. Even if all factors are met, a non-compete will still be subject to an equitable test by the Court concluding with whether the agreement is enforceable. Since some courts disfavor non-competes, the rule of reasonableness will be paramount. ■