LYCOMING LAW ASSOCIATION

LUNCH AND LEARN

MARCH 15, 2006

EMPLOYMENT AGREEMENTS, RESTRICTIVE COVENANTS, AND TRADE SECRETS – A PRIMER ON PENNSYLVANIA EMPLOYMENT LAW ISSUES

J. DAVID SMITH
McCORMICK LAW FIRM
835 WEST FOURTH STREET
WILLIAMSPORT, PA 17701
(570) 326-5131
(570) 601-0248 (FAX)
dsmith@mcclaw.com

I. EMPLOYMENT AT WILL

A. In the absence of a contract for a fixed term of employment, the general presumption in Pennsylvania is that employment is at-will, i.e., it is terminable without notice by either the employer or the employee. See, e.g., Yaindl v. Ingersoll-Rand Co., 281 Pa.Super. 560, 422 A.2d 611 (1981).

B. Where a contract is for a fixed term, it is generally terminable only for cause.

C. In order for an employee to prove an employment contract that is not an at will agreement, that employee should have a written contract specifying the duration of the contract.

D. There are some instances, however, where an oral contract can be shown to have created an agreement that trumps the presumption of at-will employment. See, e.g., Lubrecht v. Laurel Stripping Co., 487 Pa. 393, 127 A.1d 687 (1956).

E. While there is a general presumption of employment at will in Pennsylvania, there are a number of significant exceptions:

(1) Public policy exceptions.

(a) These exceptions are limited, and they are decided on a case-by-case basis:

(i) Polsky v. Radio Shack, 666 F.2d 824 (3d Cir. 1981) (polygraph test);

(ii) Field v. Philadelphia Electric Co., 388 Pa.Super. 400, 565 A.2d 1170 (1989) (reporting violations of law);

(iii) Reuther v. Fowler & Williams, Inc., 255 Pa.Super. 28, 386 A.2d 119 (1978) (jury duty).

(2) Collective bargaining agreements.

(3) Certain public employees have job protection.

(a) Most public employees are at-will employees as a matter of law, and their at-will employment cannot be changed, even with board action. See Stumpp v. Stroudsburg Municipal Authority, 540 Pa. 391, 658 A.2d 333 (1995).

(b) However, a number of public employees have tenure and they can only be terminated for cause. While teachers have tenure and that is well known, most, if not all, all school employees may be terminated only for certain, statutorily defined causes. 24 P.S. § 5-514.

(c) Employees of public housing agencies and civil service employees also have job protection.

(4) Employment discrimination claims generally raise circumstances in which the defense of at-will employment does not apply. In order to defend against such claims, an employer must generally show some legitimate business reason for termination. E.g., McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973).

II. RESTRICTIVE COVENANTS

A. Employers may wish to place impediments on the ability of some or all of their employees to work for competitors following the termination of their employment. Such restrictive covenants are viewed with a certain measure of distaste by courts as restraints on trade. Courts are thus somewhat reluctant to enforce such agreements if they fail to satisfy certain conditions, and they will be strictly construed against the employer. Hayes v. Altman, 438 Pa. 451, 266 A.2d 269 (1970).

B. Where, however, the appropriate prerequisites are in place, restrictive covenants will be enforceable in accordance with their terms, since it is a well settled principle in Pennsylvania that a "restrictive covenant is valid if it is reasonably limited in duration of time and geographic extent, reasonably necessary to protect the employer without imposing an undue hardship on the employee, ancillary to an employment relation and supported by consideration." Records Center, Inc. v. Comprehensive Management, Inc., 363 Pa.Super. 79, 83-84, 525 A.2d 433, 435 (1987).

C. Restrictive covenants may also be enforceable outside the employment context. Indeed, a restrictive covenant ancillary to a sale of business is generally enforceable for a longer period and with a lesser degree of scrutiny than a restrictive covenant in an employment agreement. See Albee Homes, Inc. v. Caddie Homes, Inc., 417 Pa. 177, 207 A2d 768 (1965). However, where a restrictive covenant is included in a medical practice management agreement for the provision of office support services rather than medical services, the covenant will not be enforceable. Williamsport Orthopaedic Associates, Ltd. v. Albert G. Liddell, M.D., Lycoming County Court of Common Pleas, Docket No.

95-02203; Williamsport Orthopaedic Associates, Ltd. v. John H. Bailey, Jr., M.D., Lycoming County Court of Common Pleas, Docket No. 00-01390.

D. Although not favored by law, restrictive covenants will be enforced where all the required bells and whistles are in place.

(1) The agreement must be ancillary to an employment relationship.

(a) While the covenant itself must be in writing, there is no requirement that it be included in a comprehensive written employment agreement. Indeed, the written agreement may be limited to the restrictive covenant. See, e.g., Records Center, Inc. v. Comprehensive Management, Inc., 363 Pa.Super. 79, 525 A.2d 433, (1987). Moreover, while the restrictive covenant does not need that to be entered into at the time of the taking of initial employment, see Maintenance Specialties, Inc. v. Gottus, 455 Pa. 327, 314 A.2d 279 (1974), if entered into after employment commences, there must be sufficient consideration to support the covenant. See Modern Laundry & Dry Cleaning Co. v. Farrer, 370 Pa.Super. 288, 536 A.2d 409 (1988).

(2) The restrictive covenant must be supported by consideration.

(a) The initiation of employment, even at-will employment, is adequate to provide consideration necessary to sustain a restrictive covenant. See e.g., Morgan's Home Equip. Corp. v. Martucci, 390 Pa. 618, 136 A.2d 838 (1957).

(b) If entered into after one's original employment, a restrictive covenant may be valid if there is new consideration in order to sustain it. See George W. Kistler, Inc. v. O'Brien, 464 Pa. 475, 347 A.2d 311 (1975).

(i) The mere extension of at-will employment will not provide sufficient consideration to support a post-employment restrictive covenant. However, if there is a change from at-will employment to employment for a fixed term, there may be sufficient consideration in that change of circumstances. See Maintenance Specialties, Inc. v. Gottus, 455 Pa. 327, 314 A.2d 379 (1974).

(ii) The possibility of a promotion or the possibility of a change in compensation may provide adequate compensation to sustain a post-employment covenant. See Modern Laundry & Dry Cleaning Co. v. Farrer, 370 Pa.Super. 288, 536 A.2d 409 (1988).

E. The restrictive covenant must be reasonably limited in time and geographic scope, and it further must be reasonably necessary for the protection of the employer.

(1) While the requirement of reasonableness regarding both the temporal and geographic scope of a restrictive covenant is well known, courts also often state that a restrictive covenant must be "reasonable and necessary for the protection of the employer. . . ." E.g., Sidco Paper Co. v. Aaron, 465 Pa. 586, 351 A.2d 250 (1976). This means, for example, that a person serving as a counter person at a fast food restaurant would not likely be bound by a restrictive covenant, since it is not reasonably necessary for the employer's protection. However, where an

employee has access to customer information or confidential product, pricing, or process information, the "reasonably necessary for the protection of the employer," the test would generally met.

(2) The agreement must be of a reasonable time limitation. Generally speaking, for an employment relationship, one year is almost always reasonable. See, e.g., Bettinger v. Carl Berke Assoc., Inc., 455 Pa. 100, 314 A.2d 296 (1974), and two years is often acceptable. E.g., Jacobson & Co. v. International Environment Corp., 427 Pa. 439, 235 A.2d 612 (1967).

(3) Some courts have upheld longer restrictions, such as three years or more. See Hayes v. Altman, 424 Pa. 23, 225 A.2d 670 (1967).

(4) The covenant must be reasonable in its geographical scope.

(a) Generally speaking, a restrictive covenant is only enforceable within the geographical area where the employer competes and the employee has provided services. See Boldt Machinery & Tools, Inc. v. Wallace, 469 Pa. 504, 366 A.2d 902 (1976).

(b) Where the appropriate requisites are met, courts have protected broad areas of coverage, such as preventing competition in entire states. See, e.g., John G. Bryant Co. v. Sling Testing & Repair, Inc., 471 Pa. 1, 369 A.2d 1164 (1977) (the state of Delaware and parts of New Jersey and Pennsylvania) and Wainwright's Travel Service, Inc. v. Schmolk, 347 Pa.Super. 199, 500 A.2d 476 (1985) (Pennsylvania, Delaware, New York, New Jersey and Maryland).

(b) Likewise, a geographical limitation may be defined by the distance from the employer's facility, on either a radius basis or other mileage measure. E.g., Hayes v. Altman, 424 Pa. 23, 225 A.2d 670 (1967) (six miles).

F. The enforceability of a restrictive covenant depends on the circumstances. If the appropriate requisites are met, however, then courts will generally enforce restrictive covenants according to their terms by way of a preliminary injunction.

(1) Where a restrictive covenant is broader than a court determines to be appropriate, the court may modify the provision to make it acceptable. See, e.g., Sidco Paper Co. v. Aaron, 465 Pa. 586, 351 A.2d 250 (1976).

(2) Where an employee is terminated, the court may find that the restrictive covenant was not "reasonably necessary" for the employer's protection. See Insulation Corporation of America v. Brobston, 446 Pa.Super. 520, 667 A.2d 729 (1995).

III. TRADE SECRET PROTECTION

A. Historically, Pennsylvania employers have had common-law protection with respect to the employers' proprietary and confidential information that is in the nature of a trade secret. Very generally, a trade secret has been defined as (1) information essential as to basic processes of the employer, usually related to the manufacture of a product, although not exclusively so; or (2) customer lists or customer information.

B. One of the best common-law descriptions of a trade secret with respect to customer information is contained in Morgan's Home Equipment Corporation v. Martucci, 390 Pa. 618, 623, 136 A.2d 838, 842 (1987):

> In many businesses, permanent and exclusive relationships are established between customers and salesmen. The customer lists and customer information which have been compiled by such firms represent a material investment of employers' time and money. This information is highly confidential and constitutes a valuable asset. Such data has been held to be property in the nature of a 'trade secret' for which an employer is entitled to protection, independent of a nondisclosure contract, either under the law of agency or under the law of unfair trade practices.

C. Trade secrets have historically been protected even in the absence of a written agreement, i.e., unlike a restrictive covenant, an employer had the ability to protect its confidential information from being misused by a former employee even in the absence of an employment agreement. See, e.g., Spring Steels, Inc. v. Molloy, 400 Pa. 354, 162 A.2d 370 (1960).

D. The common-law protections for trade secrets provided by Pennsylvania law have now been embodied in a statutory scheme, namely, the Pennsylvania Uniform Trade Secrets

Act, 12 Pa.C.S.A. §§ 5301 to 5308, which has been effective in Pennsylvania since April, 2004 (the "Act"). Pursuant to the Act, trade secret is defined as:

> "Information, including a formula, drawing, pattern, compilation including a customer list, program, device, method, technique or process that:
>
> > "(1) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.
> >
> > (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

E. In accordance with the Act, misappropriation of a trade secret occurs when there is an

> "(1) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or
>
> (2) disclosure or use of a trade secret of another without express or implied consent by a person who:
>
> > (i) used improper means to acquire knowledge of the trade secret;
> >
> > (ii) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was:
> >
> > > (A) derived from or through a person who had utilized improper means to acquire it;
> > >
> > > (B) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or

> (C) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
>
> (iii) before a material change of his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake."

F. The Act specifically provides for injunctive relief to protect trade secrets. 12 Pa.C.S.A. § 5303.

G. Additionally, the Act also provides for compensatory damages, 12 Pa.C.S.A. § 5304(a), and, in the appropriate case, exemplary damages. 12 Pa.C.S.A. § 5304(b).

H. The Act furthermore authorizes attorney's fees, expenses, and costs to a prevailing party. 12 Pa.C.S.A. §5305.

I. The Act defines the statute of limitations as three years. 12 Pa.C.S.A § 5307.

J. While the Act appears to preempt former common-law remedies, see 12 Pa.C.S.A. § 5308, it does not apply to exclude any civil remedies that may be in addition to those authorized by statute and contained in an agreement, and the Act likely will be interpreted consistently with Pennsylvania case law on the subject.

K. Notwithstanding the existence of the Act, it remains true that the protection of trade secrets, at least from an employer's perspective, is best preserved through a written contract and specific language.