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Employment Contracts - Restrictive Covenants

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EMPLOYMENT CONTRACTS—RESTRICTIVE COVENANTS—The Pennsylvania Supreme Court has held, in a case of first impression, that a restrictive covenant limiting an employee from practicing optometry within a radius of six miles from the office of his employer for a period of three years from the termination of his employment would not be enforced by an injunction where the three-year period had long since expired and the employer had sold his practice.

Hayes v. Altman, 438 Pa. 451, 266 A.2d 269 (1970).

Dr. Theodore L. Altman, an optometrist, went to work under a written agreement, as an assistant to Dr. Thomas A. Hayes, the appellee, on January 1, 1959. The agreement contained a restrictive covenant under which appellant agreed not to compete with appellee by engaging in the practice of optometry in the Borough of Monroeville, or within a radius of six miles of Dr. Hayes' office for a period of three years from the termination of the contract. Dr. Altman, within a few months after he was discharged in 1964, opened an office for the practice of optometry in the Borough of Monroeville.

The supreme court, in the first *Hayes* Case,[1] held that the restrictive covenant was reasonable as to duration and area; it was necessary for the protection of the employer. However, since the decision was not rendered until January 20, 1967, more than three years after termination of employment, the injunction was not granted. Passage of time made injunctive relief inappropriate.

On appeal the supreme court stated that because restrictive covenants are partial restraints upon the free exercise of trade they should be strictly construed. It was noted that this is particularly true when such a contract is ancillary to an employment agreement rather than the sale of a business. It followed that an injunction would not be granted to enforce a restrictive covenant when the restrictive period had by its terms expired.

Restrictive covenants as that in the instant case have had a long history. Such covenants comprise one of the "traditional common law restraints of trade." Through the years their development and treatment in the courts have reflected economic and social changes in society.[2]

From this history a general rule that may be derived is that such

1. Hayes v. Altman, 424 Pa. 23, 225 A.2d 670 (1967).
2. Blake, *Employment Agreements Not to Compete*, 73 HARV. L. REV. 625, 626 (1959-60).

covenants are valid and will be upheld by the courts if they are reasonable under all of the circumstances.[3] Courts, as did the court in *Hayes*, point out the great hardships imposed upon an employee who has entered into such an agreement.[4] It is noted, however, that these agreements are necessary for the protection of the employer. Lawyers,[5] doctors,[6] accountants,[7] architects,[8] and other persons, whose confidential relationships to clients are formed while in the service of an employer, must be prevented from utilizing these relationships to compete with their former employers.[9]

In determining the reasonableness of restrictive covenants courts apply certain pronouncements which are derived from contrasting employee covenants with sale covenants. "[T]here is more freedom of contract between seller and buyer than between employer and employee, —the latitude of permissible restraint is more limited between employer and employee, greater between seller and buyer."[10] Courts look with favor upon sales covenants, construing them liberally.[11] It is suggested that the decision in *Hayes* is a logical and reasonable extension of the well-developed and established principle that restrictive covenants should be strictly construed, particularly when ancillary to employment agreements versus the sales of businesses.

In the instant case the court held that the "appellee's remedy for a breach of the covenant, now that its time period has elapsed, lies in an

3. Arthur Murray Dance Studios of Cleveland v. Witter, Ohio Com. Pl., 1962, 105 N.E.2d 685, 691, 62 Ohio L. Abst. 17 (1952). In a case noted for its humor and hard factual examination made of the actual business operation, an Ohio court of common pleas refused to uphold a restrictive covenant against a former dance instructor of the Arthur Murray Dance Studio. The court held that the evidence did not establish a threatened irreparable injury as would entitle the plaintiff to the relief sought.

4. Morgan's Home Equipment Corp. v. Martucci, 390 Pa. 618, 631, 136 A.2d 838, 846 (1957). It is clear that such covenants prevent an employee from practicing his trade or skill. It is true that he may work outside the area named in the contract, but certain difficulties and expense will be encountered by having to move to a location beyond the area of potential competition. If the employee decides not to move, but to remain in the area and change his profession, it may not be easy to transfer his particular experience and training to another line of work.

5. Toulmin v. Becker, 69 Ohio L. Abs. 109, 124 N.E.2d 778 (Ct. App. 1954).

6. Dodd, *Contracts Not to Practice Medicine*, 23 B.U. L. Rev. 305 (1943); Millet v. Slocum, 4 App. Div. 2d 528, 167 N.Y.S.2d 136 (1957); Keen v. Schneider, 202 Misc. 298, 114 N.Y.S.2d 126 (Sup. Ct.), *aff'd*, 280 App. Div. 954, 116 N.Y.S.2d 494 (1952).

7. Ebbeskotte v. Tyler, 127 Ind. App. 433, 142 N.E.2d 905 (1957); Racine v. Bender, 141 Wash. 606, 252 Pac. 115 (1927).

8. Continental Paper Grading Co. v. Howard T. Fisher & Associates, 3 Ill. App.2d 118, 120 N.E.2d 577 (1954).

9. Kreider, *Trends in the Enforcement of Restrictive Employment Contracts*, 35 U. of Cin. L. Rev. 16, 21 (1966).

10. Arthur Murray Dance Studios of Cleveland v. Witter, Ohio Com. Pl., 1962, 105 N.E.2d 685, 704 (1952).

11. *Id.*

action of assumpsit for damages or in a proceeding for an accounting, not in a decree of specific performance." While it is true that such a remedy is theoretically available, it is relatively ineffective in practice[12] since damages are speculative. This was recognized in *Wilkinson v. Colley*,[13] a case where a similar restrictive covenant existed between two physicians. The court in *Wilkinson* allowed an equitable remedy though an action at law for damages also existed. The court did not feel that the plaintiff had an adequate remedy at law since there was an uncertainty in the calculation of damages from the breach of the covenants; the measure of damages was largely conjectural.[14] From the very nature of the contract the court felt that an action at law would be an inadequate remedy for its persistent violation during the restrictive period.[15]

The *Wilkinson* case is factually distinguishable from the instant case. There the time period in the contract had not expired, so the court could grant an injunction. In *Hayes* the time period having expired, the only alternative was the theoretical, but ineffective action at law.

To make perfectly clear the situation in which appellee was placed, it is necessary to point out the difficulty involved in obtaining a preliminary injunction prior to a determination of the validity of a restrictive covenant. Courts are not bound to grant preliminary injunctions unless the proof of irreparable damages is indubitable and convincing.[16] Where restrictive covenants are involved the question whether the covenant is enforceable is before the court. If a preliminary injunction is granted and the court were to find the covenant unenforceable, the defendant would be put to the expense and delay of recouping his loss in a suit against the plaintiff. Since the preliminary injunction if issued

12. Blake, *supra* note 2, at 691.
13. 164 Pa. 35, 30 A. 286 (1894).
14. *Id.* at 43, 30 A. at 288.
15. *Id.* at 44, 30 A. at 288.
16. Plunkett Chemical Co. v. Crump, 101 P.L.J. 365 (1953). The essential prerequisites for the issuance of a preliminary injunction are: first, that it is necessary to prevent immediate and irreparable harm which could not be compensated by damages; second, that greater injury would result by refusing it than by granting it; and third, that it properly restores the parties to their status as it existed immediately prior to the alleged wrongful conduct. *Alabama Binder and Chemical Corp.* v. *Pennsylvania Industrial Chemical Corp.*, 410 Pa. 214, 215, 189 A.2d 180, 181 (1963). Even more essential, however, is the determination that the activity sought to be restrained is actionable, and that the injunction issued is reasonably suited to abate such activity. Unless the plaintiff's right is clear and the wrong is manifest, a preliminary injunction will not generally be awarded. *Keystone Guild, Inc. v. Pappas*, 399 Pa. 46, 159 A.2d 681 (1960); *Herman* v. *Dixon*, 393 Pa. 33, 141 A.2d 576 (1958).

may cause greater injury than the alleged wrong, the preliminary injunction may be denied.[17]

A restrictive covenant may also be enforced by injunction. But, as in the instant case, in areas where the courts are crowded and slow moving, the court's decision as to whether or not the covenant will be enforced cannot be quickly obtained. Due to the inadequacies of the possible remedies an employee may take his chances by breaching the covenant and waiting to see what the court will decide.

Contracts of this nature are generally entered into between parties bargaining at arms length. Perhaps they should provide for an additional remedy, themselves. One possibility would be a liquidated damages clause. These clauses may be used today to safeguard against the exact situation that occurred in the present case.

Liquidated damages clauses have been used in employment contracts similar to the instant case.[18] Courts have found, however, that sums stipulated and agreed upon between the contracting parties were too high and were not really a fair determination as to the amount of damages that the employer suffered.[19]

A liquidated damages clause may be used successfully, however. When this is done it will have a dual effect. First, an employee, after his employment contract is terminated, will think twice before breaching such a restrictive covenant not to compete if he knows that by such breach he will be required to pay his ex-employer the named amount. Second, it will have the effect of providing the employer with a remedy if his employee should breach the restrictive covenant. In short, an employer by incorporating a liquidated damages clause provides himself with a remedy.

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17. Plunkett Chemical Co. v. Crump, 101 P.L.J. 365, (1953).
18. Srolowitz v. Roseman, 263 Pa. 588, 107 A. 322 (1919).
19. *Id.* The name by which a penalty or liquidated damages clause is called is but of slight weight, the controlling elements being the intent of the parties and the special circumstances of the case. Keck v. Bieber 148 Pa. 645, 646, 24 A. 170 (1892). The following statement contained in *March* v. *Allabough*, 103 Pa. 335, 341, has often been quoted as the test for determining whether a particular term will be enforced as a liquidated damage provision. "[T]he question . . . is to be determined by the intention of the parties, drawn from the words of the whole contract, examined in the light of its subject matter and its surroundings; and that in this examination we must consider the relation which the sum stipulated bears to the extent of the injury which may be caused by the several breaches provided against, the ease or difficulty of measuring a breach of damages, and such other matters as are legally or necessarily inherent in the transaction."