Contracts Against Competitive Employment

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While information and experience gained in working for one company may be of extreme value to another engaged in the same business, there are times when restrictions operate—both against the employee in passing on the information and against the company that attempts to prevent it.

IN THE CONTRACTS of a manufacturer of electrical capacitors with its employees it was stipulated by the employee, "That he will not at any time during said employment disclose to anyone any information he may acquire during said employment relating to any of the processes, formulae, plans, circuit devices or methods developed, acquired, manufactured or practised at any time by said corporation in its business and that he will not use any of said processes, formulae, plans, circuit devices or methods or his knowledge of the same except in the course of his employment by the corporation."

Approximately 8,000 of the employment contracts of this manufacturer contained this stipulation and as a consequence, this stipulation featured in litigation involving a great majority if not all of the manufacturers of electrical capacitors in the United States.

"It is quite clear," said the court in denying the application for an injunction against the employment by competitors of those who had signed these agreements, "that the contract goes beyond the protection of trade secrets and embraces anything that the employee saw or learned during his employment. The agreement given this construction puts a restraint upon the employees' right to labor or exercise their skill greater than is necessary for the fair protection of this employer and therefore, such agreement is unenforceable."

To this the court added a quotation from an earlier decision by one of the Federal courts. "The law is settled that a contract in restraint of labor which seeks to prevent one of the contracting parties from exercising his skill or labor generally, without limitation as to time or place or which attempts to put a restraint upon his right to labor or to exercise his skill greater than is necessary for the fair protection of the other party, is void."[1]

Closely similar circumstances were involved in an action before the New Jersey courts a few years later. There the employment contract by the manufacturer of hearing aid instruments with the manager of a district sales office provided, "Upon the expiration or termination of this contract from any cause whatsoever the manager agrees that he will not engage directly or indirectly in the business of manufacturing and/or selling any products or devices of the kind or similar to the products or devices at such time being manufactured and sold by the manufacturer or in any way engage in competition with the manufacturer or any agents or managers of the manufacturer, either directly or indirectly, as principal or as agent or employee in the territory or within an area extending fifty miles on every side thereof during the period of twelve months from the date of termination or expiration."

This manager after leaving that employment had engaged in selling a competing product within the area prescribed by this agreement. In forbidding him continuing in that employment the court outlined the features that are necessary to a valid and enforceable contract of this character.

"It is entirely settled in this state that a negative covenant ancillary to a contract of employment is valid and enforceable if it is reasonably limited in time, space and scope. In determining the validity of a covenant consideration should be given to the nature of the product and the business of the employer.

"In these days of modern transportation and communication it would appear that with respect to a business of nationwide scope, in the development of which large sums of money have been expended for advertising and good will a covenant whereby the employee agrees not to engage in competitive employment for a period of one year within a radius of 50 miles is not to be held so unreasonable as to justify the court withholding relief."[2]

In contrast to this agreement held reasonable and enforceable by the New Jersey court is one held invalid by the Supreme Court of Indiana a few months ago. Stipulations against employment by a competitor in this agreement were:

"Employee for a period of three years after leaving company's employment for any reason whatsoever shall not in the United States or Canada, without first obtaining company's written permission, engage in or enter the employment of or act as advisor or consultant to any person, firm or corporation engaged in or about to become engaged in the manufacture" of the products of this employer. The area of this employee's activities had been restricted to northern Indiana.

In its refusal to lend aid to the enforcement of this stipulation against the employee who had subsequently entered the employ of a competitor the court said:

"As an incident to his business the employer was entitled to contract with regard to and thus to protect the good will of his business. Elements of this good will include 'secret or confidential information' such as the names and addresses and requirements of customers and the advantages acquired through representative contact with the trade in the area of their application. These are property rights which the employer is entitled to protect."

Then in a comment on the rights of the employee under such circumstances the court continued, "However the same is not true regarding the skill of the employee as acquired or the general knowledge or information he has obtained which is not directly related to the good will or value of the employer's business.

"Knowledge, skill and information, except trade secrets and confidential information, become a part of the employee's personal equipment. They belong to him as an individual for the transaction of any business in which he may engage just the same as any

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[1] Sprague Electric Co. v. Cornell Dubilier Electric Corp., *62 F. S.* 1, August 7, 1945.

[2] Sonotone Corporation v. Hall, *64 Atl. 2d 473, New Jersey*, March 9, 1945.

part of the skill, knowledge or information or education that was received by him before entering the employment. Therefore on the termination of his employment he has a right to take them with him. These things cannot be taken from him although he may forget or abandon them.

"An employee may contract to conditionally forego these personal attainments as a consideration for his employment only where their use adverse to his employer would result in irreparable injury to the employer. This would occur only in the area of his employment. Therefore a covenant which would limit his employment with a competitor beyond the scope of his present employment is void."[3]

Not only must these restrictions against the employment by competitors or the undertaking of a competitive business be reasonable in the area affected but reasonable in the period of time they continue.

In another contract against such competitive employment involved in an action in the New York courts, it was provided that the restriction against competition "continue in full force as to all its stipulations for an indefinite period after its expiration until terminated by notice in writing by either party one year in advance."

In its affirmance of the decision of a lower court which had characterized this restraining provision as, "Such a restraint savors of servitude unrelieved by an obligation to support on the part of the master," the Court of Appeals of that state held:

"An employee will not be perpetually restrained from working for another except to prevent a breach of contract. The surrender for an unlimited time of the right to use the skill, knowledge and experience which a workman brings to the service of his employer as a condition, has never been enforced by injunction."[4]

In the old decisions of the courts contracts against competitive employment, in the opinion of the courts of those days, had no good in them. "The mischief which may arise from them (1) to the party by the loss of his livelihood and the subsistence of his family and (2) to the public by depriving it of a useful member," was adhered to with the anti-monopoly fanaticism that has characterized our law from its earliest days. "Another reason," according to those ancient decisions, "is the great abuses these voluntary restraints are liable to do, as for instance from corporations who are perpetually laboring for exclusive advantages in trade and to reduce it into as few hands as possible."

The English judge uttering that comment nearly two and a half centuries ago might well have recalled the famous comment of Cromwell, quoted by a contemporary Federal judge as one that should be written over the portals of every church, every school, every court house and legislative body in the United States, "I beseech ye in the bowels of Christ, think that ye may be mistaken."[5]

However it was to be asserted in a later English decision that, "Contracts for the partial restraint of trade are upheld, not because they are advantageous to the individual with whom the contract is made and the sacrifice by that much of the rights of the community, but because it is for the benefit of the public at large that they should be enforced.

"Many of these partial restraints on trade are consistent with public convenience and the general interest and have been supported. And of such a class of cases is a tradesman, manufacturer or professional man taking a clerk or servant into his service with a contract that he will not carry on the same trade or profession within certain limits.

"In such a case the public derives an advantage in the unrestrained choice which such a stipulation gives to the employer of able assistants and the security it affords that the master will not withhold from the servant instruction in the secrets of his trade and the communication of his own skill and experience, from the fear of his afterwards having a rival in the same business."[6]

Many years later this recognition of the right to restrain the hiring of employees by competitors was set out in an opinion of a Federal judge, later President of the United States, William Howard Taft:

"The contract must be one in which there is a main purpose to which the covenant in restraint of trade is merely ancillary," was asserted here to be the law. "The covenant is inserted only to protect one of the parties from the injury which in the execution of the contract or enjoyment of its fruits, he may suffer from the unrestrained competition of the other. The main purpose of the contract suggests the measure of protection needed and furnishes a sufficiently uniform standard by which the validity of such restraints may be judicially determined. In such a case if the restraint exceeds the necessity presented by the main purpose of the contract it is void for two reasons. First, because it oppresses one party to the contract without any corresponding benefit to the other. And, second, because it tends to a monopoly."[7]

Before a Connecticut court a few months ago was an appeal in an action to enforce a stipulation of this character against a former employee, that, "The employee agrees also that for a period of two years after the termination for any cause of said employment that he will not, either in competition with or for a competitor of the employer, solicit, sell or install to any of the employer's customers whom said employee may in the course of his employment, have served.

"The employee also agrees that for a period of two years after the termination for any cause, of said employment, he will not either in competition with or for a competitor of the employer sell, solicit or install within an area of 35 miles from the city of Waterbury."

In holding that the restraints imposed on the employee were excessive and hence, the contract unenforceable, the Connecticut court summarized the principles of the established law.

"It is well known that an employee gives little thought to a restriction such as we are concerned with because he is anxious and therefore intent upon getting a job and is willing to make such promises as are declared necessary as a condition precedent.

"On the other hand the employer, too, is engaged in a struggle for survival and may attempt every effort to gain and retain the good will of his customers. A reasonable balance must be maintained and each conflict must be fully evaluated on its own merits.

"Almost without exception the law is that where the restriction is excessive in the beginning and its reach is greater than is necessary for the employer's protection against 'unfair' competition, or it provides for restraint of an employee from competing after the termination of his employment in a territory exceeding that in which the employer does his business, the restriction has been considered excessive and therefore invalid.

"The test of its validity is the reasonableness of the restraint it imposes. To meet this test successfully the restraint must be limited in its operation with respect to time and place and afford no more than a fair and just protection to the interests of the party in whose favor it is to operate without unduly interfering with public interest."[8]

[3] Donahue v. Permacel Tape Corp., *127 N.E. 2d 235, Indiana*, June 20, 1955.

[4] Kaumagraph Co. v. Stampagraph Co., *138 N.E. 485, New York*, January 23, 1923.

[5] Learned Hand: *Spirit of Liberty*, page 229.

[6] Mallan v. May, *11 Mees. & W. 652.*

[7] United States v. Addyston Pipe & Steel Co., *85 Fed. 271*, page 80. February 8, 1898.

[8] Nesko Corporation v. Fontaine, *110 Atl. 2d 631*, Connecticut, February 19, 1954.