The 'Freedom to Work' Act and What It Means for Noncompetes in Pa.

By Lauri A. Kavulich

A bill has been quietly sitting in the Pennsylvania House Committee on Labor and Industry that would outlaw covenants not to compete in the commonwealth except for very narrow exceptions. House Bill Number 1938, co-sponsored by Democrats Tom Caltagirone, Anthony DeLuca, Mike Driscoll and Republican David Zimmerman titled the "Freedom to Work" Act, would render covenants not to compete illegal, unenforceable and void except for a few exceptions such as the sale of a business, dissolution of a partnership (or the dissociation of a partner), and a covenant that was in effect prior to the effective date of the bill.

In the memorandum to fellow representatives regarding the bill, Rep. Caltagirone cites the improving economy and unemployment rate, stating that removing the restrictions on mobility in the workforce would allow employees with "in demand" skills to take better paying jobs and stay in Pennsylvania, since they do not have to find positions outside the geographic area covered by the noncompete agreement. He also states that the "indentured servitude system" of noncompete agreements hurts small businesses and prevents them from hiring the best and brightest because they cannot afford to pay an employee during the period of the noncompete agreement. See Memorandum of Rep. Thomas R. Caltagirone dated March 22, 2017, regarding "Prospective Ban on Restrictive Covenants in Employment Agreements."

I have been on both sides of litigation regarding this issue in Pennsylvania. I have heard lawyers say that noncompetes in Pennsylvania are presently unenforceable anyway. It is not the case, and noncompete agreements are very much enforceable in Pennsylvania under the right circumstances today.

As it now stands, the law in Pennsylvania does permit the enforcement of noncompete agreements if they are ancillary to an employment relationship between an employee and an employer; they are supported by adequate consideration; the restrictions are reasonably limited in duration and geographic extent; and the restrictions are designed to protect the legitimate interests of the employer. The determination regarding the enforceability of a noncompetition covenant "requires the application of a balancing test whereby the court balances the employer's protectable business interests against the interest of the employee in earning a living in his or her chosen profession … and then balances the results against the interest of the public," see *J.C. Erlich v Martin*, 979 A.2d 862, 865 (Pa.Super.Ct. 2009).

Pennsylvania courts have consistently held that the taking of employment is sufficient consideration to enforce a covenant not to compete. Further, under Pennsylvania law, covenants are "reasonably limited if they are 'within such territory and during such time as may be reasonably necessary for the protection of the employer … without imposing undue hardship on the employee'," as in *Morgan's Home Equipment v. Martucci*, 136 A.2d 838, 844 (Pa. 1953). A two-year restriction has been found by courts to be reasonable, and a geographic area that encompasses the employer's business, even nationwide, has been found to be reasonable. Therefore, covenants not to compete that are reasonable and are fashioned to protect a company's legitimate business interests are presently enforceable in Pennsylvania.

Pennsylvania House Bill 1938 closely follows the California law banning noncompete agreements. Sections 16600-16602.5 of the California Business and Professional Code voids

contracts which restrains anyone from engaging in a lawful profession, trade or business. California lists the same exceptions as the proposed Pennsylvania bill, namely, the sale of a business, the dissolution of a partnership or the disassociation of a partner. North Dakota has a similar law that mimics the language of the California law (N.D. Century Code Section 9-08-06). Oklahoma has a watered-down version that allows the former employee to engage in a similar business as the former employer "as long as the former employee does not directly solicit the sale of goods, services or a combination of goods and services from the established customers of the former employer. Noncompete agreements are valid in one form or another in all other states.

To determine what the Pennsylvania bill, if passed in its present form, would look like for employers, we can look to what has happened in California. While the proposed Pennsylvania bill does not mimic the language of the California bill, the principles are the same, with the same exceptions.

For years, it appeared that even after the law was passed, some restrictions on employment were still allowable in California in very limited circumstances. The California Supreme Court, in *Edwards v. Arthur Anderson*, 44 Cal. 4th 937 (2008), changed that. In its ruling, the Supreme Court found that all restrictive covenants, except those covered by express statutory exceptions, are invalid and void as against public policy. Further, the court found that customer nonsolicitation provisions were also void and unenforceable. What is most notable is that the judicial balancing act and reasonableness, which right now is the law in Pennsylvania, (and was the law in California prior to *Edwards)*, has been eviscerated. The court stated any restraint is void and Section 16600 "represents a strong public policy of the state which should not be diluted by judicial fiat." Therefore, since *Edwards*, there has been no "rule of reason" or "balancing of hardships" to interpret the statute as anything but a complete and total ban on restrictive covenants in California. North Dakota still has some limited circumstances where courts found non-competition agreements to be valid.

If Pennsylvania does follow suit and adopt legislation similar to California, it remains to be seen whether the Pennsylvania courts will carve out limited non-statutory exceptions. However, if the Pennsylvania courts follow the California Supreme Court regarding the interpretations of the legislation, noncompete/non-solicitation agreements in Pennsylvania will be void and unenforceable except in the sale of a business, dissolution of a partnership or a partner leaving a partnership.

So how close is Pennsylvania to joining California and North Dakota with regard to restrictive covenants? Not that close. The bill has been sitting in the House Committee on Labor and Industry since November 2017. The committee has not taken up the bill nor scheduled any votes on it. In addition, right now, there is no indication that the House will reconvene after the election and prior to the end of the session. Therefore, the bill may die with the end of the legislative session if no more legislative days are scheduled. It could be introduced during the next legislative session, but with everything else the legislature will be dealing with during the next session, it may not find its way out of committee.

Reasonable covenants not to compete remain valid in Pennsylvania. However, practitioner beware. If you are advising a national client on restrictive covenant provisions, I recommend you look at California and North Dakota law and craft agreements that do not run afoul of the laws of those states. Further, each state in the United States has its own laws that may limit the scope of noncompetition agreements in those states. One size does not fit all, and it remains to be seen

whether Pennsylvania will follow California and North Dakota in banning noncompetition agreements altogether and adopt the "Freedom to Work" bill.

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