PUBLICATION

An Overview of Tennessee Law Regarding Non-Competition Agreements

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Often employers invest significant resources in training and developing employees. Prudent employers recognize that, as unfortunate as it may be, employment relationships do not always go as planned. These employers might wish to protect their interests, financial and otherwise, in the event an employment relationship is discontinued. The legal mechanism by which an employer can achieve such protection is a restrictive covenant, known as a non-competition agreement.

Tennessee courts take a reluctant approach to the enforcement of non-competition agreements. Viewed as restraints of trade, such agreements are disfavored, and are always construed in favor of the former employee. Fortunately for employers, the terms of a non-competition agreement will be enforced when they are found by a court to be reasonable. Unfortunately for employers - who typically prefer predictability in legal matters - there is no rigid formula for determining whether a non-competition agreement is reasonable. Rather, the reasonableness of a particular non-competition agreement involves an inquiry into the specific facts and circumstances surrounding an employment relationship. However, several stalwart principles have emerged that can guide employers in drafting non-competition agreements that effectively protect their interests.

Tennessee courts consider the following factors when assessing the reasonableness of a non-competition agreement: (1) the consideration supporting the agreements, (2) the threatened danger to the employer in the absence of such an agreement, (3) the economic hardship imposed on the employee by such a covenant, and (4) whether or not such a covenant is inimical to public interest. Note that the second and third factors are particularly important and are the most often litigated.

1. Consideration

Consideration can be defined in its most basic sense as a set of promises between parties, one for the other, that binds those parties to act in accordance with those promises. Non-competition agreements, like any contract, must be supported by consideration that is adequate under the circumstances. Adequate consideration is present when non-competition agreements are signed prior to, or contemporaneously with, the start of an at-will employment relationship. Simply put, the promise of employment by the employer is made in consideration of the promise by the employee to not compete.

However, the need for a non-competition agreement does not always manifest at the time of hire; a change in a current employee's relationship with his employer, or in the business of the employer itself, might necessitate a post-hire non-competition agreement. The Tennessee Supreme Court has held that continued at-will employment may provide adequate consideration for a non-competition agreement in certain circumstances. In determining whether continued performance under an at-will employment situation is sufficient consideration, the Court considers the period of employment after execution of the agreement along with the circumstances under which the employee leaves. Of course, an at-will employee can be discharged for any reason, or no reason at all, but a discharge which is arbitrary, capricious or in bad faith will have a bearing on whether a court will enforce a non-competition covenant.

2. Threat of Danger to the Employer

This factor speaks to the scope of interests an employer is permitted to protect through a non-competition agreement. An employer must show that it has a "legitimate business interest," the protection of which justifies restraining the economic activity of a former employee. Of course, competition always presents the potential of harm to the business of an employer. Accordingly, some employers might wish to restrain any and all competition by a former employee. The courts are clear, though, that for a non-competition agreement to be enforced, the protected interest must rise beyond *ordinary competition* such that without the non-competition agreement the employee would gain an *unfair advantage* in future competition with the employer.

Legitimate, protectable, interests are normally found in the concealment of trade secrets to which an employee is privy (such as the oft-cited Coca-Recipe which, according to lore, resides in its sole printed form in a mysterious vault in Atlanta), confidential or proprietary business practices, other confidential information of which an employee has knowledge, and customer and vendor lists generated by the employer. Non-competition agreements have also been held to be valid when an "employee closely associates or has repeated contact with the employer's customers so that the customer tends to associate the employer's business with the employee." In other words, if an employee has become the "face of the company," so to speak, restraining competition by her would likely be a legitimate interest.

It is important to note that the general knowledge, skills, and abilities of an employee do not represent protectable interests of the employer. These always belong to the employee, even if acquired through expensive training provided by the employer.

3. Economic Hardship Imposed on the Employee

This factor most often involves an assessment of the temporal and territorial limitations imposed on an employee by a non-competition agreement. The time and territorial limits must be no greater than necessary to protect the business interest of the employer. With respect to time restraints, prohibiting a former employee from ever working for a competitor would likely not be considered reasonable. However, there is no formula for determining what an acceptable timeframe is; it would depend on the circumstances of the employment relationship and the nature of a particular business or industry.

Likewise, with respect to territorial limitations, the courts have not created a bright line rule, but rather look to the facts and circumstances of each case. However, it has become clear that restricting a former employee such that he cannot work anywhere, or even unnecessarily limiting the territory in which he can work, is not reasonable. For example, a restaurant chain with locations in all 50 states could not restrict its former chef from working in restaurants in any state in which it operates. Tennessee courts have gone so far as to hold that a chain of parking garages with facilities in 46 major U.S. cities could not restrict a former employee from working in "any city in which it operates." As a general rule, such territorial limitations should be limited to areas in which the employee previously worked. As stated by the Tennessee Supreme Court, "noncompetition covenants, which embrace territory in which the employee never performed services for his employer, are unreasonable and unenforceable."

Note that geographic and time limitations which are found to be unnecessarily broad, can be modified by a court so as to make the covenant reasonable and enforceable.

4. Inimical to the Public Interest

This factor is not relevant to most employers. It largely encompasses non-competition agreements in professions that involve a public interest, such as the practice of medicine or law. These professions, among others, entail a personal relationship between the professional and the patient or client. These relationships are highly fiduciary and peculiarly dependent on the patient's or client's trust and confidence in the physician

consulted or attorney he or she chose to retain. In both contexts, restrictive covenants have a destructive impact on those relationships, and are thus considered inimical to the public interest and invalid.

Conclusion

In summation, and to quote the Tennessee Supreme Court, "If there is a legitimate business interest to be protected and the time and territorial limitations are reasonable, then non-compete agreements are enforceable." When drafting non-competition agreements, employers should objectively consider the interests they seek to protect, and work to do so in a way that is reasonable for both them and their employees. These employers should also keep in mind the fact-specific scrutiny with which a court will analyze a non-competition agreement, and attempt to tailor the restrictive covenant as narrowly as possible, in terms of scope, territory, and time, to ensure enforceability while still adequately protecting a legitimate business interest.