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RESTRICTIVE COVENANTS

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Background

Covenants restricting competition in Florida have generated immense attention among employers, employees, lawyers and the courts. Decades ago, at common law, restrictive covenants were considered to be invalid restraints of trade and were not enforceable. In 1953 Florida enacted its first statute on restrictive covenants, signaling that the Legislature acknowledged the necessity to protect legitimate business interests. The statute authorized courts to enforce restrictive covenants to prevent unfair competition. In the employment arena, unfair competition typically meant losing business to a competitor who obtained your valuable knowledge and experience by means of your ex-employee. Enforceable restrictive covenants afforded some protection against such losses. Restrictive covenants can also be an issue in connection with the sale of a business or company. These materials are limited to restrictive covenants as they affect the employer-employee relationship.

The court decisions in the decades of the 1970's and 1980's seemed to consistently favor employers. The approach focused more on the simple concept of freedom of contract. That is, courts seemed more inclined to enforce the provisions of a covenant in accordance with its terms and without focusing particularly on whether unfair competition was an underlying issue. Sometimes the image of a pendulum is used. Doing so, you would conclude that in this era the pendulum was on the side of the employer.

The Legislature reacted to the far movement of the pendulum with amendments to the statute in 1990. A copy of that statute, § 542.33, is attached. It remains significant because it continues to govern restrictive covenants entered into on or after June 28, 1990, but before the new statute which became effective July 1, 1996.

The legislative amendments of 1990 succeeded in moving the pendulum back through the middle and, arguably, into the side favoring the employee. One court has stated: "Then in 1990 the legislature severely weakened covenants in favor of the breaching competitor . . ." King v. Jessup, *infra* at 340. The statute has been the subject of criticism in legal journals, and its application has not been consistent by courts throughout the state.

The 1990 amendment to the statute came to be seen as flawed because it did not provide objective standards for implementation by the courts, and the result contributed to unpredictability. Your learned counsel, in response to your simple (and reasonable) question of whether a particular non-compete agreement was enforceable, was placed in the unhappy position of not being able to give a clear or reliable answer.

The thrust of the 1990 amendments was an effort to deprive the courts of the ability to automatically enforce a non-competition covenant against an ex-employee. The operative language was the direction that: ". . . the courts shall not enter an injunction contrary to the public health, safety, or welfare or in any case where the injunction enforces an unreasonable covenant not to compete or where there is no showing of irreparable injury." § 542.33(2)(a). Defenses to enforcement were thus provided to employees and to their clever counsel, with no specific guidance for the courts. From the employer's viewpoint, some help was retained by the provision that: ". . . use of specific trade secrets, customer lists, or direct solicitation of existing customers shall be presumed to be an irreparable injury and may be specifically enjoined." Id. In other words, part of what the legislature hath taken away hath seemingly been restored. Translation - under the right

circumstances (i.e. a clear and compelling case of unfairness by the ex-employee), enforcing the non-compete agreement could still be almost automatic. But, uncertainty always lurked just under the surface.

The New Statute

In 1996 the Florida legislature responded to the lobbying efforts of the Business Law Section of The Florida Bar and adopted, in essence, a model statute which the Section had developed to address multiple concerns about the enforcement, and predictability of the enforcement, of restrictive covenants. The new statute, § 542.335 (copy attached) became effective July 1, 1996. While the statute represents a wholesale revamping of the methodology for enforcement of restrictive covenants, it is not a general and universal panacea. For reasons of due process, it necessarily applies only to actions determining the enforceability of restrictive covenants entered into on or after July 1, 1996. Restrictive covenants entered into prior to that date continue to be governed by the rules and court decisions under the statute in effect when the covenant was created.

Reasonableness Required

The statute allows the enforcement of contracts that restrict or prohibit competition during or after the term of the restrictive covenant so long as the contract is reasonable in time, area, and line of business so long as it complies with the other requirements of the statute.

Writing Required

The courts may not enforce a restrictive covenant unless it is in writing and is signed by the person against whom enforcement is sought.

Legitimate Business Interests are Protected

To enforce a restrictive covenant the person seeking enforcement must plead and prove the existence of one or more legitimate business interests, defined to include:

1. Trade secrets, as defined in § 688.002(4). That statute provides:

"Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process that:

(a) 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; and

- (b) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.
2. Valuable confidential business or professional information that otherwise does not qualify as trade secrets.
 3. Substantial relationships with specific prospective or existing customers, patients, or clients.
 4. Customer, patient or client goodwill associated with: (a) an ongoing business or professional practice, by way of tradename, trademark, servicemark or "trade dress"; (b) a specific geographic location; or © a specific marketing or trade area.
 5. Extraordinary or specialized training.

**ANY RESTRICTIVE COVENANT NOT SUPPORTED BY A LEGITIMATE BUSINESS
INTEREST
IS UNLAWFUL AND IS VOID AND UNENFORCEABLE.
§ 542.335(1)(b).**

Burden or Proof/Modification by the Court

A person seeking enforcement of a restrictive covenant must plead and prove that the specified restraint as stated in the contract "is reasonably necessary to protect the legitimate business interest or interests justifying the restriction." If the person seeking enforcement makes a prima facie showing that the restraint is reasonably necessary, then the burden shifts. The person opposing the enforcement must then establish that the contractually specified restraint is "overbroad, overlong, or otherwise not reasonably necessary to protect the established legitimate business interest or interests." Should the court determine that the restraint is overbroad, overlong or otherwise not reasonably necessary, the court shall modify the restraint and grant only the relief reasonably necessary to protect the established legitimate business interest.

§ 542.335(1)(c).

Rebuttable Presumptions as to Length of Restriction

In the case of a restrictive covenant sought to be enforced against a former employee, agent, or independent contractor, and which is not associated with a sale of a business, then the court "shall presume reasonable in time any restraint 6 months or less in duration and shall presume unreasonable in time any restraint more than 2 years in duration." § 542.335(1)(d)(1). Thus, a "safe harbor" is established giving specific objective guidelines to the courts in determining a reasonable time for the restraint.

All presumptions are rebuttable presumptions. That is, the court is not necessarily bound by the presumption, but the presumption will prevail unless evidence is given to support a different period of restriction. To alter the periods stated in the presumption the burden would be on the person seeking enforcement of a covenant to show a compelling reason to enforce a term longer than 2 years. Conversely, the burden would be upon the person opposing the enforcement to show why a term of 6 months or less is not reasonable.

Trade Secrets

Covenants of nondisclosure are also encompassed by § 542.335. In determining the reasonableness in time of a post-term restrictive covenant predicated on the protection of trade secrets, the court "shall presume reasonable in time any restraint of 5 years or less and shall presume unreasonable in time any restraint of more than 10 years." § 542.335(1)(c).

Third Party Beneficiary

Typically contracts are enforceable by the parties to the contract. In some circumstances, a stranger to a contract may nevertheless be entitled to enforce it if he is deemed to be a third party beneficiary. The statute provides that enforcement of a restrictive covenant cannot be refused on the grounds that the person seeking enforcement is either a third party beneficiary or is an assignee or successor to a party to the contract, provided certain qualifications are met. § 542.335(2)(f). The qualifications are:

- In the case of a third party beneficiary, the restrictive covenant must expressly identify the person as such and expressly state that the restrictive covenant was intended to benefit such person.
- In the case of an assignee or successor, the restrictive covenant must expressly authorize enforcement by the party's assignee or successor.

Judicial Guidelines for Interpretation

Unlike the prior statute, and in an effort to create more certainty in application, the Legislature included several mandates for courts reviewing restrictive covenants. The specific directions include:

- Hardship not a defense. The courts shall not consider any individualized economic or other hardship that might be caused to the person against whom enforcement is sought. § 542.335(1)(g)(1).
- The courts may consider as a defense the fact that the person seeking the enforcement is no longer in business in the area or type of business that is the subject of the covenant, but only if such discontinuance did not result from a violation of the restriction. § 542.335(1)(g)(2).
- The courts shall consider all other pertinent legal and equitable defenses. § 542.335(1)(g)(3).
- The courts shall consider the effect of enforcement upon the public health, safety and welfare. § 542.335(1)(g)(4).
- Certain former defenses have been removed. The courts construing restrictive covenants are now required to favor providing reasonable protection to all legitimate business interests established by the person seeking enforcement. Certain rules of construction are also modified. Specifically, courts shall not employ any rule of contract construction requiring that a restrictive covenant be construed narrowly, or against the restraint, or against the drafter of the contract. § 542.335(1)(h).

Public Policy

Courts are prohibited from refusing enforcement on the ground that a restrictive covenant violates public policy unless such public policy is "articulated specifically by the court and the court finds that the specified public policy requirements substantially outweigh the need to protect the

legitimate business interest established by the person seeking enforcement of the restraints." § 542.335(1)(l).

Injunctive Relief

The court shall enforce a restrictive covenant by "any appropriate and effective remedy, including, but not limited to, temporary and permanent injunctions." Irreparable injury is presumed upon a showing of the "violation of an enforceable restrictive covenant." A bond is required in all cases. A provision waiving an injunction bond is not enforceable. § 542.335(1)(j).

Attorneys' Fees

A good drafting practice is to include a provision for attorneys' fees in a restrictive covenant agreement. In the absence of such a provision, the parties are each left to bear their own attorneys' fees under the prior statute. The new statute changes this result, and now provides that in the absence of a contractual provision the court may award attorneys' fees to the prevailing party in any action seeking the enforcement, or challenging the enforceability of, a restrictive covenant. The statute also provides that the court shall not enforce any contractual provisions seeking to limit the court's authority with respect to the award of attorneys' fees. § 542.335(1)(k).

Court Decisions

Kephart v. Hair Returns, Inc., 685 So.2d 959 (Fla. 4th DCA 1996).

Applicable statute - § 542.33. The court allowed competition, and reversed the grant of an injunction by the trial court, when it appeared that customers of the former employer followed the employee, but had not been "solicited" to do so. The reasoning is poor in that the contract at issue also prohibited competition. The court noted that under the statute: "There is no prohibition against servicing those customers who voluntarily follow an employee to her new place of employment."

Bradley v. Health Coalition, Inc., 687 So.2d 329 (Fla. 3d DCA 1997).

Applicable statute - § 542.33. The appeal court reversed the entry of an injunction against a former employee. The case was returned to the trial court for further consideration. The trial court was directed that it must consider defenses at the temporary injunction hearing. An employer may be denied injunctive relief if it has "unclean hands," which in the context of this case was the allegation that the employer was knowingly selling unsafe products and committing fraud upon its customers. The court also reaffirmed the defense of excuse or release from performance, stating that if the employer is itself in default or has given cause for the non-performance by the employee, then it has no standing in equity to seek injunctive relief. The rule was also stated this way: ". . . a material breach of the agreement allows the non-breaching party to treat the breach as a discharge of its contract liability." The court also ruled that a liquidated damages clause in the noncompetition agreement did not preclude injunctive relief.

King v. Jessup, 698 So.2d 339 (Fla. 5th DCA 1997).

Applicable statute - § 542.33. In spite of compelling facts to uphold an injunction by an employer physician against an employee physician who literally set up a competing practice a block away, the court focused on the issue of irreparable injury and declined to do so. Under the statute irreparable injury was not presumed except in instances which were found to be not applicable. Direct solicitation of former patients give rise to a presumption, but the court found that the employee doctor's advertisement in the local paper announcing his new practice address did not

constitute direct solicitation. The court also found that the fact that past patients voluntarily sought out the doctor at his new practice did not establish direct solicitation.

Balasco vs. Gulf Auto Holding, Inc., 707 So.2d 858 (Fla. 2d DCA 1998).

Applicable statute - § 543.335. The case demonstrates grounds which the court accepted as compelling legitimate business interests. Under the new statute, it can then be expected that the covenant would be upheld. It was. The covenant was a nonpiracy agreement by which a former sales manager at Courtesy Toyota agreed to refrain from soliciting or influencing other employees to leave the dealership for a period of three years. The court found that the agreement was necessary to protect the substantial investment that Courtesy made in specialized training which was used to promote productivity and to maintain a competent and specialized sales team. It found the period of prohibition to be presumptively unreasonable and reduced the period of prohibition to two years.

American Residential Services, Inc. v. Event Technical Services Inc., 715 So.2d 1048 (Fla. 3d DCA 1998).

Applicable statute - § 542.335. Interestingly, the point on appeal turned on the fact that the parties argued the wrong statute to the lower court, that is the predecessor § 542.33. The court found, however, that both parties bore the burden to cite the correct law, and found no prejudice. As a result, a temporary injunction was upheld. Another issue was whether the protection of confidential information, which did not meet the trade secret standard, was nevertheless a legitimate business interest. The court ruled that it was.

Don King Productions, Inc. v. Chavez, 717 So.2d 1094 (Fla. 4th DCA 1998).

Applicable statute - § 542.335. Injunctive relief was denied because no irreparable harm was shown. The contract at issue was an exclusive promotional contract for a prize fighter. Chavez breached the agreement by signing up for a fight through another promoter. King did not press for an injunction before the fight. The court found that it had waived the right for injunctive relief and that there was no irreparable harm because the proceeds of the fight were available to satisfy any damages. The court also ruled that any presumption of irreparable injury was a rebuttable presumption.

CHS Financial Services, Inc. v. Small Business Consultants, Inc., 722 So.2d 245 (Fla. 2d DCA 1998).

Applicable statute - § 542.33. Though a restrictive covenant was at issue, the dispute was not over an injunction, but rather concerned an award of damages for breach of the agreement. The award of damages was reversed on appeal, the court finding that there was no solicitation by the employee who was bound by the noncompete agreement. Rather, the court found that his services were sought out by the customer and that there was no direct solicitation.

Austin v. Mid State Fire Equipment of Central Florida, Inc., 727 So.2d 1097 (Fla. 5th DCA 1999).

Applicable statute - § 542.335. Mid State, a fire equipment sales and servicing company, obtained an injunction against a former employee. The court ruled that a legitimate business interest was shown, but limited the injunction to the relief necessary for the reasonable protection of the legitimate business interest. Austin was not barred from working for a competitor, but was prohibited from soliciting customers and disclosing pricing information. The court noted that the current (the "new") statute seeks a balance to not unnecessarily impede competition, to allow competitors to hire experienced workers, and to allow employees to secure better paying positions.

Dias v. John Adcock Insurance Agency, Inc., 729 So.2d 465 (Fla. 2d DCA 1999).

Applicable statute - § 542.33. The court enforced a waiver of the bond requirement otherwise applicable as a requirement to obtain an injunction. The result is now changed under the new statute at § 542.335(1)(j).

Flickenger v. R.J. Fitzgerald & Company, Inc., 732 So.2d 33 (Fla. 2d DCA 1999).

Applicable statute - § 542.335. The case demonstrates the applicability of the statutory presumption as to the length to a restriction. The trial court granted an injunction to enforce a three year restrictive covenant. The case also involved an issue relating to the bond required to support the injunction. A \$10,000 bond was ordered, but no evidentiary hearing was held. The ruling was reversed as to the three year injunction because there was no evidence to rebut the statutory presumption capping the non-compete period at two years. The court also ruled that an evidentiary hearing was required to set the amount of the injunction bond and that both parties were entitled to present evidence as to the appropriate amount of the bond.

Aero Kool Corporation v. Oosthuizen, 736 So.2d 25 (Fla. 3d DCA 1999).

Applicable statute - § 542.335. The court ruled that a temporary injunction for a six month period was proper to protect the legitimate business interest in having provided extensive, specialized training in aircraft component repair. The fact that the ex-employee was working for a company which was not a direct competitor was apparently not persuasive as a reason to deny the injunction.

Benemerito & Flores, M.D.'s, P. A. v. Roche, M.D., 751 So.2d 91 (Fla. 4th DCA 1999).

Applicable statute - § 542.335. An injunction was not granted in light of evidence that the former employer materially breached the employment agreement by refusing to properly calculate, and to pay, bonus compensation. The case reaffirms the rule that the prior employer's failure to fully compensate the employee serves to relieve the employee of any further obligation under the contract.

Anich Industries, Inc. v. Raney, 751 So.2d 767 (Fla. 5th DCA 2000).

Applicable statute - § 542.335. An industrial tool and equipment supplier sought an injunction to enforce a non-compete agreement against an individual who was employed for about three months in sales. The ex-employee went to work for a competitor. The court found that there was no legitimate business interest in need of protection. The court was influenced by several factors, including the short length of employment, the lack of trade secrets or valuable confidential information available to or acquired by the ex-employee, the readily accessible sources for customer identification, and the lack of "substantial relationships" shown to have been developed by the ex-employee.

Rollins, Inc. v. Parker, 755 So.2d 839 (Fla. 5th DCA 2000).

Applicable statute - § 542.335. The parent company of the exterminating company failed to obtain an injunction against an ex-employee who went to work with another pest extermination business. The decision turned on an interpretation of Georgia law, but included the interesting observation that Sears Pest Control and Orkin were not direct competitors because "their methods of doing business were completely different."

Infinity Radio Inc. v. Whitby, 780 So.2d 248 (Fla. 4th DCA 2001).

Applicable statute - § 542.335. An injunction was proper to prohibit an on-air personality from working at a competing radio station. The employment agreement began in 1995 (i.e., governed under the former statute § 542.33), but was amended in 1999 (i.e., after the effective date of the new statute). The 1999 amendment did not comply with the requirement of the new statute that enforcement by an assignee must be expressly authorized in the agreement. The court found, however, that the 1999 amendment amounted to a brand new agreement and was enforceable as such.

Shields v. The Paving Stone Company, Inc., 796 So.2d 1267 (Fla. 4th DCA 2001).

Applicable statute - § 542.335. Demonstrating the ability of the court to modify an agreement to what it deemed to be reasonable terms, an injunction was affirmed on appeal but was narrowed. The former employer proved a legitimate business interest in need of protection, i.e. its customer log, but that only required an injunction which prohibited solicitation of the customers identified on the customer log. The ex-employee was not barred from working for a competitor. The court ruled that the prohibition would not include customers obtained through the open bidding process.