Non-Competes in Fixed Term Agreements: Special Care Required

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Special caution is required concerning restrictive covenants that are ancillary to employment agreements for a fixed term (as opposed to an employment agreement for an at-will employee). Whether such covenants may be enforced could depend upon: (1) written renewal of the employment agreement upon expiration; and/or (2) the inclusion of language expressly stating that restrictive covenants contained in the agreement survive termination of the agreement. Consider the following hypothetical:

A senior executive signs an employment agreement providing her with a fixed term of employment for two years from the date the agreement was executed. The agreement contains a restrictive covenant that applies for one year following expiration of the agreement. Upon the expiration of the two-year term, the company is negotiating the terms of a new employment agreement with the executive. As sometimes happens, the negotiations drag on for a period of months, sometimes actively, and sometimes not at all. During this drawn out and ongoing period of negotiations, the executive continues to serve and is compensated according to the terms of the expired employment agreement. Everyone seems to be content with the status quo, and a year goes by. Ultimately, the negotiations fail, and the executive sets out for greener pastures with a competitor.

Can the company enforce the one-year restrictive covenant? Assuming the agreement meets the prerequisites for enforceability, is it enforceable for twelve months from the date of termination of employment or has the twelve-month term of the non-compete already run (because it began running upon the expiration of the term of the agreement)? Before dropping a bundle on litigation, employers should consider that different courts have viewed this factual scenario differently.

In Gray v. Prime Management, 912 So.2d 711, (Ct. App. Fla. 2005), the court ruled that a covenant contained in an expired employment agreement violated the statute of frauds. In that case, a property management company sued its former president seeking to enforce a non-compete contained in the former president's employment contract. Gray was hired by Prime Management in May 1997. The following month he entered into an employment agreement, the term of which was to commence on the effective date, May 1, 1997, and end five years from that date, "unless terminated pursuant to section 6 of this Agreement, or unless extended by the mutual agreement of the parties hereto." The agreement contained a non-compete precluding Gray from competing with Prime Management and from soliciting Prime's clients for a period of eighteen months "following termination of this Agreement." Gray continued to work for Prime upon the expiration of the agreement, but he eventually left Prime in July of 2003 and subsequently started a competing business.

The trial court granted Prime Management's motion for a temporary injunction, finding that "an implication arose that Prime and Gray had mutually assented to a new contract containing the same provisions as the old." But the appellate court saw it differently. The appellate court held that the oral extension of Gray's written employment contract did not satisfy the Florida statute of frauds, which precludes enforcement of any agreement not capable of performance within the space of one year from its making.

Courts in other states have reached different conclusions under similar circumstances. These courts -- like the trial court in Gray -- noted that because the parties continued to operate under the agreements after their expiration, there is an inference that the parties assented to another contract for a term equal in length to the original agreement. See e.g., DeMuth v. Miller, 652 A.2d 891 (Pa. Super. Ct. 1995) ("Where a contract of employment for a definite time is made and the employee's services are continued after the expiration of the time, without objection, the inference is that the parties have assented to another contract for a term of the same length with the same salary and conditions of service."); Smith v. Shallcross, 69 A.2d 156 (Pa. Super. Ct. Nov. 15, 1949) (same); Karlin v. Weinberg, 77 N.J. 408, 1165 n. 2 (1978) ("Unless the post-employment restraint was superseded by a subsequent agreement, something we cannot and need not ascertain from the present record, the post-employment covenant, if reasonable, is effective and not terminated by the expiration of the contract.")

There are two lessons to be learned from the competing views of these court decisions. First, when an employment agreement for a fixed term expires, employers should obtain written confirmation from employees that the parties intend to continue the existing agreement, even if only temporarily. Second, when drafting an employment agreement for a fixed term, employers should consider including language that expressly states that all restrictive covenants survive termination of the agreement. Although the

enforcement of any given restrictive covenant will often depend upon the facts and circumstances of each case and the vagaries of state law, taking these steps will increase the prospects for enforceability.

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