Consideration and the 4th dimension

Laurance Jerrold
Woodbury, NY

You’ve had an associate working for you for just under a year. Things are going fairly well, and you think she might be a good candidate for partnership consideration. However, she hasn’t committed yet for a number of reasons but seems to be leaning toward yes. Your 1-year associateship agreement is set to terminate shortly. Now that she is going to stay on, at least for a while, you want to include a restrictive covenant (RC), something you did not have in the first agreement. You and she negotiate back and forth, eventually agreeing on terms. She signs the new associateship agreement, and you both acknowledge that as soon as the attorney can draft the RC, she’ll sign that as well. It takes a few weeks, but she signs the RC about a month or so after signing the main agreement.

Well, you guessed it, a few months later, your associate begins working 1 day a week for another orthodontist within the restricted geographic area. You file for injunctive relief to prevent her from doing so, as is your right as stated in the RC. The court denies the injunction on the basis of the premise that you may not succeed on the merits. Why? Because for an RC to be enforceable in this situation, it has to be supported by adequate consideration. The above synopsis is the gist of Rullex v TelStream, No. 27 EAP 2019 (Sup. Ct. Pa., June 16, 2020).

At this point, you may need to know what consideration is in the legal sense. The Judicial Education Center (http://jec.unm.edu/education/online-training/contract-law-tutorial/contract-fundamentals-part-2; accessed July 23, 2020) defines the elements of a contract to be offer, consideration, acceptance, and mutuality of assent. An offer is just that; I offer to straighten your teeth. Consideration is the value of whatever is being exchanged as it relates to the offer: my fee for straightening your teeth is $4000.00. Consideration does not have to take the form of money. It can be a promise to do something or refrain from doing something. Instead of money, it can also take the form of an object or service, such as is found in bartering. Consideration is the value that induces the parties to enter into a contract. Value is relative to the parties. As long as each party believes the value to be fair, the actual amount of the consideration is irrelevant. Acceptance is also just that; the other party accepts the offer: $4000.00 seems to be a fair price—when can we start. Acceptance can be in the form of words, writing, or acts that mirror accepting the offer and can be express or implied. Finally, there must be mutual assent or, as some would say, a meeting of the minds. This means that both parties understand what is being offered, how it is being accepted, and the consideration being rendered to induce performance by each party. In other words, both parties understand and agree to the terms of the contract. Now, back to the case.

The trial court noted that 1 aspect of enforceability of RCs is that they must be supported by consideration. Adequate consideration can take the form of an offer of employment if executed at the inception of the employment relationship. If a covenant is signed after the employment relationship begins, the RC requires additional consideration to be enforceable. Because there was no additional consideration, and the RC was signed after the employment contract was signed, and after the period of employment had begun, the court refused to issue the injunction. On appeal, the superior court affirmed the trial court’s ruling, noting that adequate consideration was missing at the time the covenant was signed. The appeals court also noted that

...a restrictive covenant need not be included in the initial employment agreement, particularly as the restriction may only be relevant after the employee “has developed a certain expertise, which could possibly injure the employer if unleashed competitively.” (Cit. Omit.)

However...any such covenant executed after the first day of employment can only be enforced if accompanied by fresh consideration ... that ... may arise from a favorable change in employment conditions, such as a promotion, a change from part time to full-time status, or an increase in benefits. ...[T]he “mere continuation of the employment relationship at the time of entering into the restrictive covenant is insufficient.” (Cit. Omit.)
On appeal to the supreme court, the court first reviewed the legal principles behind RCs by noting that, in general, they are disfavored because of their inherent nature to restrain trade and the potential to restrict the former employee from gainful employment. However, modern business practices have made them necessary in that they function as important tools that “...prevent individuals from learning [employers’] trade secrets, befriending their customers and then moving into competition with them.” Covenants not to compete are also there to protect an employer’s legitimate business interests and must be reasonably limited in terms of duration of effect and geographic restriction.

Regarding the issue of when the RC was actually signed, the court looked at prior case law that held a covenant had been enforced when it was contemplated and agreed to by the parties before the beginning of employment, signed by the employee on the third day of work and accepted by the parent company of the employer on the 12th day of work. The quote relied on was that it was enforceable because it was “…an ancillary part of the taking of regular employment as opposed to an afterthought to impose additional restrictions on the unsuspecting employee.” But the court was also quick to point out that a different case had found such a covenant unenforceable even though it was signed on the first day of work as the parties had not previously reached any agreement concerning such a restriction. Thus, the court concluded that what makes or breaks the enforceability of a covenant that was not signed as part of an employment contract but was signed after employment had begun was the intent of the parties to be bound by the contemplated restrictions.

In summarizing its decision, the court stated:

Hence, the test for whether new consideration is required has not ordinarily centered on whether the employee physically executed the agreement precisely on (or before) the first day of employment. Rather, and as explained, restrictive covenants have been deemed enforceable absent fresh consideration in situations where the parties contemplated and intended that, incident to the employment relationship, the employee would be bound by its substantive terms – and the employee ultimately signed it shortly after the first day. (Emphasis Added, not in original text)

...for a restrictive covenant executed after the first day of employment to be enforceable absent new consideration, the parties must have agreed to its essential provisions as of the beginning of the employment relationship. Only in that circumstance will the covenant in substance be “ancillary to taking employment.” (Cit. Omit.)

...there must be a meeting of the minds on the terms of [the] restrictive covenant. Thus, before preliminary negotiations ripen into contractual obligations, there must be evidence of mutual assent to the terms of a bargain. (Cit. Omit.)

The supreme court finding that no such meeting of the minds existed affirmed the unenforceability of the covenant.

**COMMENTARY**

Before I go any further, it is important to note that some states, not many, but a few, just plain out don’t recognize the enforceability of RCs. However, most states do. They are an integral part of the business relationship between employer and employee. The employer has spent a good deal of time, money, blood, sweat, and tears developing and building his practice into a valuable asset. He has cultivated a referral base. There is a very legitimate business interest to protect. So long as the restrictions involved are reasonable relative to the scope of time and geography, and the employee is not prevented from the ability to engage in gainful employment outside the scope of the restrictions, and so long as the restrictions are not against public policy considerations, a restrictive covenant will be upheld.

Okay, so what is reasonable? The answer is, it depends. Are we talking about a small town Smallville or are we talking about a metropolis Metropolis? In rural areas, the geographic restriction may be much larger than in urban areas—think tens of miles as opposed to a radius of blocks in a grid pattern. Because of the nature of orthodontic practice and the fact that our patients’ treatments can run 2 years or more, it is not uncommon, nor is it unreasonable for the temporal restriction to run for several years. All of this is fair. All of this is reasonable. Provided, of course, that all of this was agreed to before Junior began working for Senior.

The offer of employment, a paycheck, an opportunity to hone one’s craft, an opportunity to become an integral part of a community, all of this has value and is the consideration on which the offer of employment is accepted. Once a contract has terminated, on the renegotiation of salary, benefits, fringes, and other perks, consideration can again be found for the enforceability of the covenant. When it fails is when Senior decides...
in the middle of an employment period that Junior is becoming well-known, well-liked, good at what they do she does, and the thought of Junior being able to leave and go down the street and compete with you becomes a real threat. At that point, requiring Junior to sign an RC without offering some additional consideration, something of value for the restrictions being imposed, will certainly be found to lack the mutuality of assent required for enforcement.

No, to be enforceable, it needs to be done, as the first words in the Old Testament state: “In the beginning”. It needs to be part of the terms of engagement, both parties agreeing to the restrictions upfront, both intending to be bound by them. Later doesn’t work unless you are willing to pay something extra for the forbearance you are asking or requiring Junior to provide. It appears that as far as consideration for covenants not to compete is concerned, timing is everything.