

Pennsylvania Employment Law

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Pennsylvania Supreme Court Holds That Sale of Business Assets Could Not Include Assignment of an Employee's Non-Compete Agreement Without the Employee's Consent

In a case of first impression, the Pennsylvania Supreme Court held that an employer may not assign a restrictive covenant not-to-compete in an employment contract without the consent of the employee. See *W. Lawrence Hess v. Gebhard and Co., Inc. and Eugene Hoaster Company, Inc.*, 808 A.2d 912 (Pa. 2002). In doing so, the Pennsylvania Supreme Court ratified the Pennsylvania Superior Court's 1997 decision in *All-Pak, Inc. v. Johnston*, 694 A.2d 347, in which the Superior Court had held that such restrictive covenants were personal and, therefore, not assignable without the express consent of the employee.

Appellant Hess had been an employee of Eugene Hoaster Company, Inc. since 1974. Hess signed an employment agreement that included a covenant not-to-compete with Hoaster after the termination of his employment. In 1996, Hoaster sold the assets of its insurance business to Gebhard and Co., Inc. The assets sold also included Hess's employment agreement. Hess did not consent to the assignment of his employment agreement to Gebhard. The amount of Hoaster's final payments for its sale of assets depended in part on the ongoing profitability of the insurance business.

After the sale, Hess went to work for a competitor's insurance company. When threatened with enforcement of the covenant not-to-compete, he filed suit against Gebhard, which then joined Hoaster as a party defendant. The trial court found that the covenant not-to-compete was enforceable.

On appeal, the Pennsylvania Superior Court affirmed, finding that the original employer, Hoaster, had retained a sufficient financial interest in the profitability of the assets

it sold to be affected by any competition from Hess's new employer. The Superior Court, therefore, saw Hess not only competing with the financial interest of Gebhard, but also competing with the financial interest of his original employer, Hoaster.

The Supreme Court reversed the Superior Court and held that, absent express consent of the employee, covenants not-to-compete are not assignable assets. Because the Supreme Court had never been faced with this issue before, the Court reviewed the history of relevant restrictive covenants and judicial opinions of federal and state courts. Historically, covenants not to compete were disfavored. As time progressed, the necessity of such restrictions became apparent and, today, covenants not to compete are found to be an "important business tool to 'allow employers to prevent their employees and agents from learning their trade secrets, be-friending their customers and then moving into competition with them.'" However, restrictive covenants must be reasonable in duration and geographical limitations.

A majority of the state courts that have examined the issue have concluded that restrictive covenants are not assignable for one of the following reasons: (1) such covenants are personal to the parties and, therefore, are not assignable; (2) employment contracts involve personal services and, therefore, are not assignable; or (3) the assignment of such contracts would be a violation of public policy.

According to the Pennsylvania Supreme Court, the employment contract "is personal to the performance of both the employer and employee, the touchstone of which is the trust that each has to offer the other." The Court concluded, "we

hold that a restrictive covenant not to compete, contained in an employment agreement, is not assignable to the purchasing business entity, in the absence of a specific assignability provision, where the covenant is included in a sale of assets.”

The Pennsylvania Supreme Court then turned to the issue of whether the restrictive covenant could be enforced by Hess’ original employer – Hoaster. The Court held that, despite the fact that it received a portion of the profits related to its former insurance business, Hoaster had sold the accounts themselves and, therefore, had no legally protectible interest in those insurance accounts. Further, the Court found that the information possessed by Hess was not of a proprietary or confidential nature. “Without a protectible business interest, Hoaster may not enforce the covenant not to compete.”

It should be noted that this case does not stand for the proposition that employment contracts in general are not assignable. The court was not asked to address that issue.

The court drew a bright line that will be increasingly important in an economy in which so much growth comes from the technology and service sectors and in which skilled employees and experienced executives are often more important than the physical assets of a company. The decision will have to be considered in employee compensation negotiations as well as in valuing transactions between businesses, such as asset sales.

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Members of K&L’s Appellate Practice, in consultation with K&L’s Employment and Labor Practice, petitioned for *allocatur*, briefed and argued the case discussed above before the Supreme Court of Pennsylvania.



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