Enforcement of Non-Competition Clauses in Employment Contracts – Tennessee

In Tennessee, courts come close to duplicating Virginia's employer-friendly environment of the neighboring states. Like Virginia, but unlike Maryland, North Carolina, and West Virginia, Tennessee views continued employment as sufficient consideration for a covenant not to compete signed after employment has begun. However, Tennessee courts allow judicial modification of overbroad non-competition agreements, where Virginia refuses to do the same. Although legitimate employer interests are not as neatly or narrowly defined as in Maryland, the Tennessee courts tend to enforce covenants designed to prevent unfair competitive advantage or use of special information. Further, Tennessee courts refuse to enforce covenants where the only issue at stake is ordinary competition or use of general skills.

In determining enforceability, Tennessee courts focus on valid consideration, reasonable limitations to time and territory, legitimate employer business interests in need of protection, disproportionate injury to the employee, and the agreement's impact on public interest. Turner v. Abbott, 94 S.W. 64 (Tenn. 1906). In Turner, the plaintiff, an established dentist, hired the defendant shortly after his graduation from dental school. Id. at 65. After working for the plaintiff for seven months, by mutually agreement the defendant stopped working for the plaintiff and left the state. Shortly thereafter, he returned to Union City and opened a competitive business, in violation of an agreement he had with the plaintiff. Id. This agreement stipulated that the defendant "would not open an office or practice dentistry in competition with complainant when he ceased to work for complainant in the town of Union City and its immediate vicinity." Id. Although this was a parol agreement, the court held it valid and enforceable in light of the five aforementioned factors. Id. at 66. This was true despite the lack of a durational element in the covenant because of its extremely limited geographical restriction. Id. at 69.

Sixty years later, the court reiterated the factors important in determining the enforceability of non-competition agreements. There, the court refused to enforce a restrictive covenant against the manager of several parking lots. Allright Auto Parks, Inc. v. Berry, 409 S.W.2d 361 (Tenn. 1966). Berry, who formerly owned several parking
businesses, sold his lots to the plaintiff, who was amalgamating many independently owned parking facilities in seventeen states and Canada. Id. at 362. In exchange for his businesses, he was given stock in the parent company, and signed an employment contract with a restrictive covenant that provided that "for a period of five (5) years after the date of termination or expiration, [Berry] will not "engage, either directly or indirectly, in the business of parking automobiles in the subject city or any other city in which he shall participate during his employment . . . or in any city in which the parent corporation of [Allright] is engaged in the parking business." Id. After the amalgamation and the signing of this agreement, Berry was elected vice-president of the corporation. Three years later, Berry resigned his position and subsequently competed against the plaintiff. Id.

Specifically, in looking at the economic burden on the defendant, the court held the covenant unreasonable, as it prevented Berry from working in forty-three cities in the United States and Canada in which he had never worked, but where the plaintiff had parking establishments. Id. at 364. The court refused to consider Berry's position as a corporate vice-president, and any confidential information he might have had access to in this position, because the agreement was intended to apply only to his job as manager of a parking business. Id. Finding the restrictions greater than necessary for the protection of the plaintiff's legitimate business interests, the court adopted the rule that "noncompetition covenants, which embrace territory in which the employee never performed serviced for his employer, are unreasonable and unenforceable." Id.

In a closer look at legitimate employer interests, the courts have found that an employee's use of general skills are not protectable, while misuse of special information is protectable. Selox, Inc. v. Ford, 675 S.W.2d 474 (Tenn. 1984). In Selox, the defendant was a former salesman for plaintiff's industrial gas and welding products business. After two years of employment, he signed a non-competition agreement providing that he "would not compete with Selox for a period of two years from and after the date of his termination within the" territory he worked for Selox at the time of his termination. Id. at 474. Two years later, his compensation package was altered, resulting in a significant reduction in his income. He resigned and began working for a company who sold a different manufacturer's welding products and no industrial gasses. Id. at 475. The court found the
agreement invalid on two counts: the protection was greater than necessary to protect the plaintiff's legitimate interests and the hardship imposed on the defendant outweighed the plaintiff's need for protection. Id. In refusing to enforce the covenant, the court found it extremely important that Ford had no access to trade secrets or confidential information, nor had Selox given him any specialized training. The court drew the line of enforceability between the "general skills and knowledge of the trade" and "information that is peculiar to the employer's business." Id. at 476. Thus the court ruled that, "in order for the employer to be entitled to protection, there must be special facts over and above ordinary competition." Id. See also Hasty v. Rent-A-Driver, Inc., 671 S.W.2d 471 (Tenn. 1984) (refusing to enforce a six-month, 100-mile radius covenant not to compete against a truck driver for plaintiff's truck driver leasing service where plaintiff's injury would result from ordinary competition, not unfair advantage); Matthews v. Barnes, 293 S.W. 993 (Tenn. 1927) (enforcing a five year, county-wide noncompetition agreement against the night manager of plaintiff's car rental business. The court found the newness of plaintiff's type of business and the confidential information to which the defendant had access were sufficient to show a legitimate, protectable interest). The Matthews court also found the non-competition clause enforceable because the customers tended to associate the employee with the employer's business. 293 S.W. 993 (Tenn. 1927).

Oddly, in Selox the court did not address the issue of valid consideration. Previously, the court had ruled that continued employment was sufficient consideration for a non-competition agreement. Di-Deeland, Inc. v. Colvin, 347 S.W.2d 483 (Tenn. 1961). In this case, the defendant was employed for ten or eleven years by a diaper laundry company, which was subsequently sold to the plaintiff. Three years later, the defendant entered into a restrictive covenant "for and in consideration of the compensation to be paid [Colvin] as such employee and in consideration of his being so employed." Id. at 484. This agreement provided that Colvin "would not go into a competing business within six months after the termination of said employment within a radius of forty-five miles from employer's plant in Chattanooga." Id. The agreement, which prohibited solicitation of plaintiff's clients and divulging of any of plaintiff's secrets, also provided that employment could be terminated by either party on two weeks notice. Id. at 484. Although the Chancellor did not find
anything mutual about the agreement, the Supreme Court of Tennessee reversed his holding, finding that continued employment was sufficient consideration for such an agreement when the terms of that agreement were reasonable. Id. at 558, 347 S.W.2d at 486. See also Central Adjustment Bureau, Inc. v. Ingram, 678 S.W.2d 28 (Tenn. 1984) (refusing to void for lack of consideration three employees' restrictive agreements. Two of the agreements were signed after employment had begun, where the only consideration for the covenants was the promise of continued employment and that promise was substantially performed); Associated Dairies, Inc. v. Ray Moss Farms, Inc., 326 S.W.2d 458 (Tenn. 1959) (refusing to enforce a covenant against a sales driver where there was no promise of continued employment beyond the day the agreement was signed).

Unlike Virginia and many of its neighboring states, Tennessee courts directly addressed the effect the method of discharge has on the enforceability of the non-competition clause. In Central Adjustment Bureau, Inc., v. Ingram, the court ruled that the circumstances under which an employee leaves employment is another factor important in determining the reasonableness of the non-competition clause. 678 S.W.2d 28 (Tenn. 1984). The court goes on to find that, “although an at-will employee can be discharged for any reason without breach of the contract, a discharge which is arbitrary, capricious or in bad faith clearly has a bearing on whether a court of equity should enforce a non-competition covenant.” Id. at 35.

Finally, Tennessee courts allow for judicial modification of noncompetition agreements that are overbroad as to time or territory restrictions. Cent. Adjustment Bureau, Inc., 678 S.W.2d 28 (Tenn. 1984). At issue was a covenant providing that "at any time within two years of termination thereof, [defendants] shall not compete within the United States, either directly or indirectly, with the corporation" by being engaged in a business that competes with plaintiff's business, by divulging any confidential information, or by soliciting plaintiff's clients. Id. at 31. The defendants were three former employees of plaintiff's debt-collection company who resigned from plaintiff's employ to begin their own competitive business. Id. at 30. One of the defendants collected client lists and information sheets from plaintiff's offices to use in his new venture. Id. at 32. The court found the agreements unreasonably broad but decided to follow the trend of other jurisdictions in adopting judicial modification.
In rejecting the "blue pencil" approach as a potentially unsatisfactory solution to an overbroad agreement, the court favored the "rule of reasonableness" approach. That is, covenants that do not show bad faith would be enforced "to the extent that they are reasonably necessary to protect the employer’s interest ‘without imposing undue hardship on the employee when the public interest is not adversely affected.’" Because there was no evidence of bad faith, the court modified these agreements to last for one year. Further, such agreements apply only to the plaintiff’s clients who had been customers as of a specific date, which was several months prior to the defendants’ resignations. But cf. Delta Corp. of America v. Sebrite Corp., 391 F. Supp. 638 (E.D. Tenn. 1974) (refusing to modify and enforce the geographically overbroad restriction prohibiting a former regional vice president of a mobile home loan originator and servicer from competing and soliciting former clients for one year, because the clients were scattered across the country).

Thus, Tennessee offers a more employer-friendly environment in the enforcement of non-competition agreements than any of Virginia’s other neighbors, (though North Carolina comes very close). In addition to continued employment sufficing as adequate consideration to support a restrictive covenant, the courts will judicially modify otherwise overbroad restrictions and enforce them as modified.