

### EMPLOYMENT CONTRACTS RESTRICTING COMPETITION

By Frederick C. Berry, Jr., J.D., CPCU

The principal asset of each independent insurance agency is its book of business or list of customers. Whether the agency splits the commissions with the producers or puts the producers on a salary, the agency is interested in preserving this book of business. The producer, on the other hand, would probably want the flexibility of being able to take his clients with him if he changes employment.



Under certain circumstances, employment contracts restricting competition will be enforced by the courts. Before the contract will be put into effect, the employer has the burden of proving that the restraint is (1) reasonably limited in time, (2) reasonably limited by geographic area, (3) not beyond that reasonably necessary for the protection of the employer's business, (4) not unreasonably restrictive upon the rights of the employee, and (5) not in contravention of public policy. *Lesner Dental Laboratories, Inc. v. Kidney*, 16 Ariz. App. 159, 492 P.2d 39 (1971).

The five criteria that must be present in an enforceable covenant not to compete overlap on the question of reasonableness. Whether a restrictive covenant is reasonable depends upon the facts and circumstances of each case. For example, an insurance agency that writes accounts located in Maricopa County could not reasonably restrict its former employees from soliciting accounts throughout Arizona. Similarly, it would be unreasonable to put no time limit on such solicitation. It would also be unreasonable to prohibit a former employee from engaging in any insurance business. Every person has the right to earn a living, and such a restraint would be unreasonable. An enforceable contract would have to be carefully created to be reasonably limited in time, geo-

ple, an agreement that an employee will not solicit the existing business and accounts of an agency for three years after employment within the geographic area in which the employer conducts business would be enforceable. It would not be reasonable to prohibit a former employee from soliciting a large commercial account merely because the former employer writes a Notary Public bond for the account.

If an existing contract is unreasonably broad, there is a split of authority as to whether or not the courts will rewrite it to make it reasonable. As a general rule, the courts will not rewrite contracts for parties. If the contract is unreasonably broad, the courts will typically declare it unenforceable in total. There is a new Arizona case, however, involving the sale of a business where the court employed a "rule of reason" to determine the reasonable scope of an unlimited restriction and prohibited the party from going beyond what the court deemed to be reasonable. *Three Phoenix Company v. Pace Industries, Inc.*, 1 CA-CIV 4773 filed March 10, 1981, supplemental opinion on motion for rehearing filed November 19, 1981. The "rule of reason" was adopted by the Arizona Court of Appeals in a case involving a sale of business. Covenants not to compete in a contract for the sale of a business are more readily put into effect by the courts because a non-competition clause is considered part of the consideration for the purchase of the business. Restrictive covenants ancillary to employment contracts, on the other hand, are more carefully scrutinized. 42 Am.Jur.2d Injunctions §115 at 869 (1969). Because the distinction drawn by the courts between restrictive covenants contained in employment contracts and covenants not to compete contained in the sale of business contracts, it is not safe to conclude that the courts will rewrite an unreasonable restriction contained in an employment contract.

What if there is no contract respecting competition upon the termination of employment? As a general rule, it is permissible for a former employee to solicit old accounts after the employee leaves his former employment. So long

knowledge acquired by him in the past and does not avail himself of trade secrets or take with him customer lists or renewal and engineering information, he is free to compete with his former employer. On the other hand, the common law will prohibit a former employee from availing himself of confidential information taken from his former employer. In the absence of an enforceable restrictive covenant, there is nothing improper about an insurance agent competing with his former employer after he terminates so long as he only avails himself of the knowledge he takes with him, and nothing more. On the other hand, it is impermissible for the former employee to take customer lists, renewal data or engineering information which the former employer considers confidential and use that data to compete with the former employer.

If a reasonable restrictive covenant is violated, the employer can go to court and generally seek an injunction as well as damages. If the employer has limited his recovery in the contract to only the

return of commission income, however, the employer would only be able to recover this commission income and would not be able to get an injunction. An injunction is a court order prohibiting a person from doing certain things. If it is violated, the matter is treated as contempt of court which may result in a fine as well as imprisonment. Because the lawsuit would arise out of a contract, the winning party would be able to recover attorney's fees as well as other damages. A.R.S. §12-341.01.

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