ANALYSIS OF THE VALIDITY AND ENFORCEABILITY OF NON-COMPETITION COVENANTS ON EMPLOYMENT CONTRACTS*

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"A human being must have occupation if he or she is not to become a nuisance to the world."
–Dorothy L. Sayers, English Mystery Author (1893 – 1957)

"Work saves us from three great evils: boredom, vice and need."
–Voltaire (1694 - 1778), Candide, 1759

I. INTRODUCTION

A person's work is without a doubt one of his most cherished and valuable possession for such is a source of financial support for him and his family's needs. No less than the Constitution guarantees this valuable right of obtaining an occupation for sustenance. A profession, trade or calling is a property right and one cannot be deprived of the right to work and the right to make a living because these are intrinsic to a human being's survival. Hence, the arbitrary and unwarranted deprivation of this particular property right normally constitutes an actionable wrong.[1] An employee is therefore free to decide on what occupation to take and consequently, also free to leave said employment and pursue another. Corollarily, a former employee may enter into fair and open competition with a former employer after termination of the employment relationship, either independently or in the service of another employer.

As with all right enshrined in the constitution, these rights end where another begins. This means that there are circumstances where workers are being prevented to engage in such endeavors by what is called

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[1] MM Promotion and Management, Inc. v. Court of Appeals, 260 SCRA 319 (1996), citing Phil. Movie Workers' Assn. v. Premier Productions, Inc., 92 Phil 8423 (1953); and National Labor Union v. Court of Industrial Relations, 68 Phil 732 (1939).

"non-competition covenant or non-competitive clauses" occasionally incorporated in an employment agreement. These clauses state that the employee promises not to compete or to work for a competitor of their employer after termination of said employment. Such a covenant commonly imposes post-employment restrictions on the employee for a limited period of time, and within a territorially limited area. These covenants generally appear in two forms, namely, ancillary to the sale of a trade or business, or ancillary to an employment contract.

Courts under the early common law were disinclined to enforce these restrictive covenants, which are broadly characterized as agreements in restraint of trade. According to the early common law of England,[2] an agreement in restraint of a man's right to exercise his trade or calling was void as against public policy. While this rule continued through successive decisions over the years, the modern rule now is that a non-competition covenant supported by consideration and ancillary to a lawful contract is enforceable if reasonable and consistent with the public interest.[3] As such, the rule being applied presently by the majority of Philippine and American jurisdictions is that a covenant restraining an employee, upon termination of employment, from competing with his or her former employer, is valid if it is reasonable in view of the circumstances of the particular case. Conversely, no anti-competitive covenant will be upheld and enforced if it appears to be unreasonable. In this regard, the Supreme Court recently addressed, albeit not completely, the issue of validity and enforceability of said non-competition covenants in the case of *Rivera v. Solidbank*[4] which will serve as the main framework for this article.

II. SCOPE OF THE ARTICLE

This article will not merely touch on what the Supreme Court ruled in the *Rivera* case. It is vital to extensively discuss the facts and circumstances surrounding an employee's non-competition covenant because generally, it is a restraint on the right to exercise one's trade or profession and it imposes certain hardships upon the said employee. In the same vein, this article will also examine the issue from the perspective of the employer who will, naturally, want the enforcement of the covenant. In addition, it will reflect both views of concurrence and dissent to the various points raised by the

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[2] Case of the Tailors of Ipswich (1615) 11 Co Rep 53a

[3] American Law Review, 'Enforceability of Agreement Restricting Right of Attorney to Compete with Former Law Firm,' 28 A.L.R.5th 420, 1995, citing Am. Jur. 2d, Monopolies, Restraints of Trade and Unfair Trade Practices § 511.

[4] G.R. No. 163269, Apr. 19, 2006.

Supreme Court in the *Rivera* case, and accordingly, this article will present other legal basis (both from Philippine laws and jurisprudence, as well as from the United States taking into account its persuasive effect on the Philippine legal system), for having propounded otherwise.

III. APPROPRIATENESS OF SUMMARY JUDGMENT ON NON-COMPETITION COVENANTS

First, the soundness of summary judgment in deciding enforceability of non-competition covenant has to be addressed. In the *Rivera* case, the employer Solidbank filed a Motion for Summary Judgment on the ground that Rivera raised no genuine issue as to the suit against him considering that he readily admitted that he signed the undertaking and that he violated it when he sought employment from another bank. Both the trial court and the Court of Appeals ruled in favor of Solidbank and granted summary judgment against Rivera. Upon elevation of the case to the Supreme Court, it reversed the previous rulings and remanded the case to the trial court for the reception of evidence.

Under the Philippine Rules of Court on Civil Proceedure,[5] for a summary judgment to be proper, the movant must establish two requisites, namely: first, there must be no genuine issue as to any material fact, except for the amount of damages; and secondly, the party presenting the motion for summary judgment must be entitled to a judgment as a matter of law. When the facts as pleaded appear uncontested or undisputed, then there is no real or genuine issue or question as to any fact and thus, summary judgment is called for. Hence, when the facts pleaded by the parties are disputed or contested, proceedings for a summary judgment cannot take the place of a trial.

Under US jurisprudence,[6] determination of whether or not a non-competition covenant is valid has been found to be dependent upon consideration of factual matters. Thus, unless there is a stipulation of *all material facts,* a case involving non-competition covenants is inappropriate for resolution on summary judgment because the court must consider at least the following factors, namely: (1) the nature and character of information sought to be protected; (2) extent to which its secrecy is vital to

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[5] Sections 1, 3 of Rule 34 of the Revised Rules of Civil Procedure.

[6] Farm Credit Services of North Central Wisconsin, ACA v. Wysocki, 237 Wis. 2d 522, 2000 WI App 124, 614 N.W.2d 1 (Ct. App. 2000).

employer's ability to conduct its business; (3) extent to which information could be had elsewhere; (4) extent to which restraint inhibits employee's ability to pursue a livelihood in area of his personal skills; and (5) extent to which a stranger could compete in provision of services former employee would be restrained from providing.

Hence, it can be said that the Supreme Court appropriately ruled the remanding of the case to the lower court for the proper reception of evidence considering that a summary judgment is improper. Having said that, a discussion on the merits of the *Rivera* case with respect to the validity and enforceability of non-competition covenants is now in order.

IV. EMPLOYEE AND BUSINESS OWNER DISTINGUISHED

It is crucial to distinguish first between situations wherein the former employee sought employment with another competitor employer and wherein he entered into a competitive business independently. The reason for this is that test of validity may differ as applied to these situations. In *Attaway v. Republic Services of Georgia*,[7] it was said that the factor distinguishing restrictive covenants ancillary to employment contracts from those ancillary to a sale of a business is that a vendor who signs a covenant in the sale of business receives an increased purchase price for doing so. Furthermore, the restrictions act to protect purchaser's legitimate business interests, such as good will and value of business. In *Hicks v. Doors By Mike, Inc.*,[8] it was ruled that in determining the enforceability of restrictive covenants, the appellate court must first decide what level of scrutiny to apply since a non-competition covenant agreement that is ancillary to the sale of a business is subject to much less scrutiny than that applied to employment contracts. Therefore, Courts have tended to differentiate between contracts in restraint of trade and contracts in restraint of employment, indicating that because of the hardship imposed upon an employee, covenants not to compete which are ancillary to employment contracts are subject to a more stringent test of reasonableness than that applied to restrictive covenants which are ancillary to the sale of a business.

Under Philippine jurisprudence, the Supreme Court has ruled way back in 1918 that while such a restraint, if imposed as a condition of the employment of a day laborer, would at once be treated as arbitrary and wholly unnecessary to the protection of the employer, it assumes a certain

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[7] LLP, 253 Ga. App. 322, 558 S.E.2d 846 (2002), cert. denied, May 28, 2002.
[8] 260 Ga. App. 407, 579 S.E.2d 833 (2003).

degree of relevance with respect to an employee who subsequently entered into competitive business by himself.[9] In the said case, Abrahamson was a former employee of Ollendorf who signed an agreement stipulating that Abrahamson will not enter into or engage himself directly or indirectly to enter in or engage in a similar or competitive business as that of Ollendorf's business. But to Ollendorf's dismay, Abrahamson subsequently put up a business by himself which is similar to said business of his previous employer. Ollendorf then filed a claim for damages for breach of contract by Abrahamson. The Supreme Court ruled in favor of Ollendorf and held that the non-competition covenant is valid. It sustained the freedom to contract by the two parties taking into account that Abrahamson, being an owner of the business, is more at level with Ollendorf than a former employee who will be subsequently employed by a competitor-employer.[10]

As can be gleaned from the foregoing, tests of validity and enforceability may vary depending on whether the former employee entered into another employment with the competitor or established a competitive business by himself. Thus, it is vital that the courts when coming across suits involving non-competition covenants, should determine first if it is an employment contract or a business creation.

V. PROTECTABLE EMPLOYER INTERESTS--IN GENERAL

It is now imperative to discuss the various employer interests that are subject of the protection of non-competition covenants and the reasons for acquiring said protection considering that the *Rivera* case involves employer-employee relationship and not business creation. In the main, if an employer does not have a legitimate business interest in preventing a former employee from competing honestly, an employee anti-competition covenant may not be enforced. To obtain enforcement of an anticompetitive covenant in an employment agreement, the employer must demonstrate that he or she has an interest which is entitled to protection from unfair appropriation by former employees.[11]

The most commonly asserted protectible employer interests are: first, the skills employee acquired in the course of employment; secondly, the confidential or unique information, such as trade secrets or customer

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[9] Ollendorf v. Abrahamson, G.R. No. 13228, Sep. 13, 1918.
[10] 6 Williston on Contracts, 'Validity of Restrictive Covenants.'
[11] Moore Business Forms, Inc. v. Foppiano, 382 SE2d 499 (1989, W. Va.).

lists; and lastly, the goodwill of the employer. This means that courts will enforce employees' covenants not to compete only where the employee had access to the employer's trade secrets, where the employee developed close relations with customers or clients, or had access to confidential customer information, or where the employee's services are deemed "special, unique, or extraordinary."[12]

A. TRADE SECRETS

The rationale for enforcing employees' non-competition covenant covenants in order to protect an employer's trade secrets is to prevent a breach of confidence.[13] If the employer has no trade secrets, or the employer's trade secrets were not disclosed to the employee, this rationale for enforcement of an employee's non-competition covenant covenant fails; and such absences tend to show the unreasonableness of the covenant.[14] To deserve protection, the secrets must be more than the general secrets of the trade not known to the general public; they must be the employer's exclusive secrets.[15] Regrettably, it is to be noted that not even the Intellectual Property Law[16] has an exact definition of what constitutes trade secrets. As such, reliance shall be made again on US law in which the Restatement of Torts[17] defined it as "any formula, pattern, device or compilation of information which is used in one's business," from which the owner derives a competitive advantage over those without the information and which is maintained by the owner as a secret.[18] In line with this definition, a mere general knowledge of the employer's business, or training of an employee in the employer's methods, does not show access to any protectible trade secrets; and the desire of an employer to prevent an employee from using common information gained during employment is not sufficient to justify enforcement of an employee's covenant not to compete.

B. CUSTOMER INFORMATION

Customer information is usually treated as a protectible interest of the employer. For obvious reasons, customer information is the bread and

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[12] 20 Am. Jur. Proof of Facts 3d 705, 'Unreasonableness of Covenant Not to Compete.'

[13] 54 Am. Jur. 2d, 'Monopolies, Restraints of Trade, and Unfair Trade Practices,' § 549.

[14] Odess v. Taylor, 282 Ala 389, 211 So 2d 805, (1968).

[15] 2 McCarthy on Trademarks and Unfair Competition (2d ed.), § 29:12.

[16] Otherwise known as Republic Act No. 8293, Jun. 6, 1997. Said law enumerated Intellectual Properties, namely patents, geographic indications, industrial designs, layout designs, trademarks, and copyrights.

[17] 54 Am. Jur. 2d, 'Monopolies, Restraints of Trade, and Unfair Trade Practices,' § 543.

[18] Restatement (Second) of Contracts, § 188.

butter of any business' revenue generation, hence it serves as basis for a covenant not to compete. Competitive advantage can be attained by an employer by mere possession of vital customer information that is not available to others. In this regard, factors such as the general availability of the information and the former employer's effort and expense in compiling it have been emphasized by the courts in determining whether the employer is protected.[19] Thus, in one case, a customer list that is already known to veteran sales representatives in the industry is not confidential and does not constitute a protectible interest on which to base a non-competition covenant agreement.[20] As with trade secrets, alleged "confidential information" about customers must be something more than a generally available list of prospective customers.[21] Similarly, an employee's knowledge of his or her former employer's main customers' needs, when it is but general information easily available to any competitor, is not a protectible employer interest on which to base enforcement of a non-competition covenant agreement.[22] Nonetheless, there are instances where the former employer's customer information is not protectible as a trade secret in its own right, but where due to the confidential nature of the employment relationship, the information affords the employee such competitive advantage that its use already constitutes unfair competition, it can enjoin a former employee from using the information to solicit business regardless of the existence of a covenant not to compete.[23] In such cases, a covenant not to compete may be enforced only to the extent of not soliciting customers or disclosing confidential customer information, but not complete employment proscription. Likewise, it has been held that a restrictive covenant contained in employment agreement was not enforceable where (1) employee established that although he was highly successful account executive, his leaving did not cause employer special harm; and (2) employer's customer lists were readily ascertainable from many sources, including brochure published by employer and widely distributed to its clients.[24]

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[19] 55 Am. Jur. 2d, 'Monopolies, Restraints of Trade, and Unfair Trade Practices,' § 708.

[20] Jefco Laboratories, Inc. v. Carroo (1985, 1st Dist), 136 Ill App 3d 793, 91 Ill Dec 513, 483 NE2d 999, later proceeding (1st Dist) 136 Ill App 3d 826, 91 Ill Dec 518, 483 NE2d 1004.

[21] 2 McCarthy on Trademarks and Unfair Competition (2d ed.), § 29:16.

[22] Trilog Associates, Inc. v. Famularo (1974), 455 Pa 243, 314 A2d 287.

[23] See Use of Customer List by Former Employee, 3 Am. Jur. Proof of Facts 2d 785.

[24] Ken J. Pezrow Corp. v. Seifert (1993, 4th Dept), 197 AD2d 856, 602 NYS2d 468, 83 NY2d 798, 611 NYS2d 130, 633 NE2d 485

C. CUSTOMER GOODWILL

A post-employment anti-competitive covenant is justified where part of the employee's services consist in creating the goodwill of customers and clients who are likely to follow the employee when he or she leaves.[25] Thus, a covenant not to compete may be enforced as to employees having substantial customer contacts, and a secret customer list is not even necessary.[26] Under the so-called customer contacts theory, if the nature of the business and the employee's position are such that personal relations between the employee and the employer's customers enable the employee to influence or control their business, the employer has a right to be protected against the likelihood that the employee, when moving on, might be able to take these customers with him or her.[27]

Bear in mind that a mere customer contact with nothing more, does not always bring the customer so completely under the employee's spell that the customer will automatically move with the employee wherever the employee goes.[28] Only in certain types of employment relationships do employees have the requisite personal hold on customers to justify enforcement of a covenant not to compete. The courts have often stated that an employee's non-competition covenant covenant is not justified if the harm caused to the employer by the employee's service to another consists merely in the fact that the former employee became a more efficient competitor, as distinguished from exploiting personal contacts with customers or clients. Accordingly, if the employer cannot prove that the former employee's acquaintance and personal relations with customers might enable the former employee to unfairly divert them to a competitor, then the covenant cannot be justified on this ground.[29]

D. EMPLOYEE'S SPECIAL, UNIQUE, OR EXTRAORDINARY SERVICES

According to some court decisions, a post-employment anti-competitive covenant is enforceable if the employee's services are special, unique, or extraordinary. Under this view, such a covenant may be enforced when the employer's business is exposed to special harm because of the special or unique nature of the employee's services.[30] To establish that the

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[25] 54 Am. Jur. 2d, 'Monopolies, Restraints of Trade, and Unfair Trade Practices,' § 546

[26] Osage Glass, Inc. v. Donovan (1985, Mo), 693 SW2d 71

[27] Budget Rent-A-Car Corp. v. Fein (1965, CA5 Ga), 342 F2d 509.

[28] Arthur Murray Dance Studios, Inc. v. Witter (1952, CP), 62 Ohio L Abs 17, 105 NE2d 685, 92 USPQ 447.

[29] 2 McCarthy on Trademarks and Unfair Competition (2d ed.), §§ 29:17, 29:18.

[30] American Broadcasting Cos., v. Wolf (1981), 52 NY2d 394, 438 NYS2d 482, 420 NE2d 363.

employee's services are special, unique, or extraordinary within the meaning of this rule, it is not sufficient that the employee excels at his or her work or that the employee's performance is of high value to the employer.[31] At the very least, it must appear that the employee's services are of such a character as to make replacement of the employee virtually impossible.[32] As a result of these limitations, and the fact that an employee's personality and attributes do not belong to the employer and are not a part of the employer's protectible goodwill, this category of protection afforded by a covenant not to compete has had limited application in practice.

VI. SOLIDBANK'S PROTECTABLE INTERESTS

It is not surprising for an employer such as Solidbank to protect its interest by requiring resigning or retiring employees to sign an agreement with the stipulation on non-employment with other banks. In this regard, the significant question now becomes whether or not Solidbank is entitled to the protection of its interests. It has been said that a banking business is so impressed with public interest where the trust and interest of the public in general is of paramount importance such that the appropriate standard of diligence must be very high, if not the highest degree of diligence[33] especially in the bank's choice of employee. Nevertheless, care must be given in granting such protection to Solidbank's interest at the expense of the employee. Does Solidbank have trade secrets that are feared to be leaked out once a former employee like Rivera gets employed by another bank? The answer may be in the negative. Banks are highly regulated entities such that processes and procedures being carried out by banks are standardized and uniform. Even a cursory search of bank trade secrets in the internet yields no useful results.

The Philippine General Banking Law of 2000[34] contains certain provisions which specifically govern the requirements for grant of loans or other credit accommodations by banks to borrowers. Under these provisions[35], the extension of loans and other credit accommodations by a

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[31] Purchasing Associates, Inc. v. Weitz (1963), 13 NY2d 267, 246 NYS2d 600, 196 NE2d 245.

[32] See Mixing Equipment Co. v. Philadelphia Gear, Inc. (1971, CA3 Pa), 436 F2d 1308, 169 USPQ 257 (applying New York law); Diesel Injection Sales & Services, Inc. v Renfro (1983, Tex App Corpus Christi), 656 SW2d 568.

[33] Philippine Commercial International Bank v. Court of Appeals, G.R. No. 121413, Jan. 29, 2001

[34] Otherwise known as Rep. Act No. 8791, "An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for other Purposes," enacted on Jun. 13, 2000

[35] Id. Sections 39, 40, to wit:

bank must be in accordance and consistent with safe and sound banking practices. As a rule, borrowing applicants are required to declare their assets and liabilities, their income and expenditures such as income tax returns filed with the Bureau of Internal Revenue or financial statements filed with the Securities and Exchange Commission. These documents can hardly be characterized as confidential documents taking into account that all banks can gain access to these documents if needed, and Solidbank cannot claim that information given by the said documents are trade secrets it can exclusively formulate. As can be gleaned from the provisions, the Monetary Board of the BSP is tasked to develop rules and regulations with respect to customer information and evaluation of credit application which is to be strictly followed by banks. Thus, it is inconceivable that Solidbank has created a special procedure for credit evaluation which can be considered as trade secrets when there are specific procedures that are prescribed by the Monetary Board and adhered to by all other banks.

In this connection, the BSP has implemented its *Bangko Sentral of the Pilipinas ("BSP") Manual of Regulations*,[36] which subjects all banks to its strict supervision and regulation. It even has the Basel Committee on Banking

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"Section 39. Grant and Purpose of Loans and Other Credit Accommodations – A bank shall grant loans and other credit accommodations only in amounts and for the periods of time essential for the effective completion of the operations to be financed. Such grant of loans and other credit accommodations shall be consistent with safe and sound banking practices.

"The purpose of all loans and other credit accommodations shall be stated in the application and in the contract between the bank and the borrower. If the bank finds that the proceeds of the loan or other credit accommodations have been employed without its approval, for purposes other than those agreed upon with the bank, it shall have the right to terminate the loan or other credit accommodation and demand immediate repayment of the obligation."

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"Section 40. Requirement for Grant of Loans or Other Credit Accommodations – Before granting a loan or other credit accommodation, a bank must ascertain that the debtor is capable of fulfilling its commitments to the bank.

"Towards this end, a bank may demand from its credit applicants a statement of their assets and liabilities and of their income and expenditure and such information as may be prescribed by law or by rules and regulations of Monetary Board to enable the bank to properly evaluate the credit application which includes the corresponding financial statements submitted for taxation purposes to the Bureau of Internal Revenue. Should such statements prove to be false or incorrect in any material detail, the bank may terminate any loan or other credit accommodation granted on the basis of said statements and shall have the right to demand immediate repayment or liquidation of the obligation.

"In formulating rules and regulations under this Section, the Monetary Board shall recognize the peculiar characteristics of microfinancing such as cash flow-based lending to the basic sectors that are not covered by traditional collateral."

[36] The Bangko Sentral ng Pilipinas Manual of Regulations for Banks, dated March 10, 2003 is the comprehensive authority on the specific subjects covered therein. The New Manual comprises substantially the regulatory issuances of the BSP, as well as those of its predecessor agency, the Central Bank of the Philippines, as they were amended or revised through the years, up to December 31, 1996. It shall serve as the principal source of all substantive banking regulations issued by the Monetary Board and the Governor of the BSP and shall be cited as the authority for enjoining compliance with the rules and regulations embodied therein.

Supervision that has developed what is so-called 'safe and sound banking practices' in the area of customer identification and record keeping. Said committee has created account opening and customer identification guidelines in its paper "Customer Due Diligence for Banks."[37] The reason for such is that customer identification is an essential element of an effective customer due diligence program which banks need to put in place to guard against reputational, operational, legal and concentration risks. It is also necessary in order to comply with anti-money laundering legal requirements and a prerequisite for the identification of bank accounts related to terrorism.[38] On this basis, it appears that customer identification and information is highly-standardized for all banks and Solidbank's method or formula for customer identification and credit evaluation is no exception.

Said Manual of Regulations likewise prescribes 'Minimum Guidelines for Correspondent Banking Account Opening and Customer Identification' which confirms that it is a banking industry practice to correspond with each other to obtain vital information of customers such as credit information.[39] All these considered, it is doubtful that Solidbank has acquired or developed specialized credit investigation procedures different from other banks that may be regarded trade secrets. Consequently, it may be said that Solidbank has no protectible trade secrets to speak of.

With respect to customer information, a bank client's information although an extremely sensitive one, is not strictly confidential to one bank. As a matter of fact, banks share credit information with each other so as to be cautioned against fraudulent individuals purporting to possess good credit standing. The Bankers Association of the Philippines even has a list of credit card holders that have terminated credit cards due to non-payment. If a person is included in the said list, he is considered to be blacklisted from all banks and credit card companies, hence said person will never be able to

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[37] Rafael Morales, "The Philippine General Banking Law Annotated," (National Publishing Cooperative, Inc., 2004 edition), page 111; also see Basel Core Principle 15 for Effective Banking Supervision.

[38] Under the said Customer Due Diligence Procedures, banks should apply their full 'Know Your Client' (KYC) procedures to applicants that plan to transfer an opening balance from another financial institution, bearing in mind that the previous account manager may have asked for the account to be removed because of a concern about dubious activities. Also, banks should never agree to open an account or conduct ongoing business with a customer who insists on anonymity or "bearer" status or who gives a fictitious name. Nor should confidential numbered accounts function as anonymous accounts but they should be subject to exactly the same KYC procedures as all other customer accounts, even if the test is carried out by selected staff. Whereas a numbered account can offer additional protection for the identity of the account-holder, the identity must be known to a sufficient number of staff to operate proper due diligence. Such accounts should in no circumstances be used to hide the customer identity from a bank's compliance function or from the supervisors.

[39] Id.

obtain a credit card again.[40] Therefore, Solidbank need not be alarmed that Rivera will divulge customer information upon transfer to Equitable Bank since said customer information may have been readily available to Equitable Bank. It should also be noted that even during the 1990's Equitable Bank is bigger than Solidbank in terms of assets and operations.[41] The present state of banking tells us that Equitable acquired PCI Bank in 1999, whereas Solidbank was acquired by Metrobank in 2000. This could only illustrate that Solidbank is not at par with Equitable in terms of banking operations. Thus, Solidbank's fear of Equitable Bank's gaining competitive advantage against Solidbank by hiring Rivera is unfounded, if not highly exaggerated.

Finally, customer goodwill and uniqueness of employee's services may not be applicable to Solidbank considering that Rivera's job does not entail interaction with clients. Credit investigation is done in seclusion,[42] thus the prospective clients cannot develop goodwill with Rivera at all. In addition, there cannot be any special or unique in Rivera's services to Solidbank. His position is not deemed irreplaceable when in fact, Solidbank allowed said position to be subject of an early retirement program. Having said all the foregoing, Solidbank has no protectable interests to speak of, hence not entitled to protection afforded by non-competition covenants.

VII. EXTENT OF RESTRAINT--IN GENERAL

Having just outlined the several protectable interests of an employer and how these apply to Solidbank, this article turns the discussion to the extent of restraint that may be enforced by a non-competition covenant. Restraint may cover namely, the type of activities the employee may engage in, territorial scope of the restriction, and the time duration. These restraints are critical factors in determining the validity and enforceability of the covenant. As will be later realized, a non-competition covenant is unreasonable, and therefore unenforceable, when it is broader in any of these respects than is necessary to protect the employer's business.

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[40] This is usually contained in the Letter for Collection of Delinquent Credit Card Payments issued by most banks.

[41] http://en.wikipedia.org/wiki/Equitable_PCI_Bank

[42] Supra, at note 32.

Proscribed activity

In general, before a covenant not to compete can be enforced, it must appear that the activities restricted by the covenant would harm a legitimate business interest sought to be protected by the employer. In some cases, the covenants involved have been assailed as prohibiting an unreasonably broad range of activities such as when the restriction imposed is against working in "any capacity" for a competitor. This will be viewed as imposing a restraint more extensive than any legitimate protectable interest of the employer.[43] In addition, a covenant not to compete may be adjudged unreasonable if the nature of the business activities in which the employee is forbidden to engage is not specified with particularity. In one case, the court refused to enforce a covenant seeking to prevent the employee from entering into "any business transactions" with a competitor upon leaving the employer's service. The court characterized the restriction as "unreasonable, indefinite and vague."[44]

Likewise, in another case, a restrictive covenant, which prohibits employee from accepting employment with competitor of employer "in any capacity," or from engaging in business "similar to" employer's business or "related trade," is unenforceable in that it imposes greater limitation on the employee than is necessary for the protection of employer and does not specify with particularity the nature of business activities in which employee is forbidden to engage.[45] In view of these cases, it can be said that the non-competition covenant in Rivera's signed undertaking amounted to an unreasonable, indefinite and vague proscribed activity since it is not specified with particularity. The stipulation merely directed "[he] will not seek employment with a competitor bank or financial institution within one year." Given this scenario, it appears that Rivera is being restrained from working in any capacity even if limited in time. Hence, said stipulation may be held to be invalid and unenforceable against Rivera.

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[43] Howard Schultz & Associates, Inc. v. Broniec (1977), 239 Ga 181, 236 SE2d 265, 1977-1 CCH Trade Cases 61480, in which the Supreme Court of Georgia refused to enforce a covenant whereby an accountant agreed that for a specified period he would not engage, directly or indirectly, in any capacity or in any business or related activity, in competition with his former employer in a particular area, or in competition with the employer's principal wherever it might operate. The court held, inter alia, that the agreement not to accept such employment with a competitor "in any capacity" was unreasonable since the nature of the business activities forbidden was not specified with particularity.

[44] Hortman v. Sanitary Supply & Chemical Co. (1978), 241 Ga 337, 245 SE2d 294, 1978-1 CCH Trade Cases 62044.

[45] BellSouth Corp. v. Forsee, 265 Ga. App. 589, 595 S.E.2d 99, 21 I.E.R. Cas. (BNA) 261 (2004), cert. denied, (May 24, 2004).

A. TIME AND AREA RESTRAINTS

In general, the reasonableness of the territorial and temporal scope of the post-employment restriction on an employee depends on the type of business, the position occupied by the employee, and the employer's interest sought to be protected.[46] Where there is a danger that the employee's contact with customers may create a likelihood that customers will follow the employee, the territorial scope of an anti-competitive covenant may be held to be unreasonable if the area of restraint is broader than the territory covered by the employee during his or her employment, in which the employee actually contacted the employer's customers.[47] Under the customer-contact rationale, restricting a former employee from competing in areas where he or she could not have established any contact with customers is deemed unreasonable because competition by the former employee outside the geographic area of the employee's employment-related activity presents no greater threat to the employer than does competition by a stranger.[48] It may also be unreasonable to restrict the employee from competing at a distance from his or her place of former employment greater than the employer's customers may reasonably expect to travel to obtain similar services.[49]

With regard to the time duration of the restraint, if the covenant is justified on the ground that the employer needs protection against the use of customer contacts developed during the employment, the issue then will be until when is a customer susceptible to influence from a personal relationship with the employee. Accordingly, it would be unreasonable to impose restrictions on the employee for a period of time beyond what is required to allow the employee's influence over customers to wane sufficiently to protect the employer.[50]

On the other hand, if the restraint is justified on the likelihood that the employee will divulge or use the employer's secret method or process, the technological life of such trade secret may be critical as to the time duration of the restraint,[51] while the territory in which the employer makes

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[46] 2 McCarthy on Trademarks and Unfair Competition (2d ed.), §§ 29:13, 29:14.

[47] 54 Am. Jur. 2d, 'Monopolies, Restraints of Trade and Unfair Trade Practices,' § 546.

[48] 2 McCarthy on Trademarks and Unfair Competition (2d ed.), § 29:13

[49] See, e.g., Cukjati v. Burkett (1989, Tex App Dallas), 772 SW2d 215 (12-mile restriction contained in veterinarian's covenant was unreasonable where evidence showed that most pet owners traveled only a few miles to obtain pet care).

[50] See Lakeside Oil Co. v. Slutsky (1959), 8 Wis 2d 157, 98 NW2d 415 (time required to obliterate in the minds of the plaintiff's customers the identification formed during the period of defendant's employment).

[51] See Restatement (Second) of Contracts, § 188, comment g (1981).

use of it may limit the geographic scope.[52] Thus, trade secret protection cannot justify a territorial restriction on competition greater than that where the employer does a substantial business and greater than that where there is a substantial basis for the expectation of expansion in the reasonably foreseeable future,[53] or a time restriction beyond the useful life of the information, as measured by the time it would take for the same information to be developed independently by a competitor,[54] or the natural obsolescence of the information due to changing conditions or otherwise.[55]

A long line of US cases have held that a wide range of time and area restraints have been found to be unreasonable under the circumstances of particular cases. Unlimited restraints are generally frowned upon and, as noted above, there is authority that covenants unlimited as to both area and time are unenforceable. Post-employment anti-competitive covenants have also been held invalid where they are unlimited as to area although limited as to time, the same holds true for covenants limited to area but unlimited as to time.[56]

VIII. TEST OF VALIDITY AND ENFORCEABILITY: REASONABLENESS

Suffice to say there is no specific statutory provision addressing the validity or enforceability of non-competition covenants. As such, Philippine case law relied largely on United States jurisprudence and common law in the determination of the legality of said covenants.

As suitably pointed out by the Supreme Court in the *Rivera* case, it is only the Philippine Civil Code which statutorily deals with the soundness of any stipulation contained in a contract. Article 1306 of the Civil Code provides that the contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order or public policy. In the same manner, as mentioned in the *Rivera* case, Philippine law cases held that the freedom of contract is both a constitutional and statutory right since a contract is the law between the parties, and courts have no choice but to enforce such contract as long as it is not contrary to law, morals, good

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[52] 2 McCarthy on Trademarks and Unfair Competition (2d ed.), § 29:13.

[53] Id.

[54] Raven v. A. Klein & Co. (1984), 195 NJ Super 209, 478 A2d 1208.

[55] Rector-Phillips-Morse, Inc. v. Vroman (1973), 253 Ark 750, 489 SW2d 1, 177 USPQ 89, 61 ALR3d 391.

[56] 54 Am. Jur. 2d, 'Monopolies, Restraints of Trade and Unfair Trade Practices,' § 545.

customs and against public policy. Considering that non-competition covenants may be regarded as not being contrary to law, morals, and good customs, what is now left to be tested is whether or not such stipulation contravenes public policy. This will eventually lead to questions of whether the covenant is unreasonable and consequently, whether it is in violation of the prohibition against restraint of trade.

Under US law, the *Restatement of Contracts*[57] provides that a deal, the performance of which would limit competition in any business or restrict the promissor in the exercise of a gainful occupation is illegal if the restraint is unreasonable. Generally, a restraint of trade is unreasonable if it is greater than is required for the protection of the person for whose benefit the restraint is imposed, creates undue hardship on the person restricted, tends to create a monopoly, or to control prices or to limit production artificially, unreasonably restricts the alienation or use of anything that is the subject of property, or is based on a promise to refrain from competition and is not ancillary to an existent employment or contract of employment.[58] In employment cases, reasonableness breaks down into three issues: (1) whether the restraint is reasonable as to the employer, (2) whether the restraint is reasonable as to the employee, and (3) whether the restraint is reasonable as to the public.[59]

In *Faust v. Rohr*[60] it was decreed that the general rule was, and still is, that contracts in restraint of trade and the like are void, on the ground that they are against public policy, similar to contracts illegal and contra mores. However, said rule has been modified in order to protect the business of the promisee, when it can be done without detriment to the public interest. The reasonableness of such restraint depends in each case on all the circumstances. If it be greater than is required for the protection of the promisee, the agreement is unreasonable and void. If it is a reasonable limit in time and space, the current of decisions is that the agreement is reasonable, and will be upheld.

Hence, the criteria for determining reasonableness of restrictive covenant in employment contract has been laid down as follows: (1) whether restraint is reasonable in a sense that it is no greater than is necessary to protect employer in some legitimate business interest; (2)

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[57] §§ 513- 516, (1932).

[58] American Law Review, 'Enforceability of Covenant against Competition in Accountant's Employment Contract,' 15 A.L.R.4th 559, 1982.

[59] Supra, at note 26.

[60] 81 S. E. 1096.

whether restraint is reasonable in a sense that it is not unduly harsh and oppressive in curtailing employee's legitimate efforts to earn a livelihood; and (3) whether restraint is reasonable from standpoint of sound public policy.[61]

Furthermore, the *Solari/Whitmyer* test provides that a non-competition covenant agreement is enforceable if it simply protects the legitimate interests of the employer, imposes no undue hardship on the employee and is not injurious to the public; wherein the first two prongs of the test require a balancing of the employer's interests in protecting proprietary and confidential information and the asserted hardship on the employee, while the third requires the reviewing court to analyze the public's broad concern in fostering competition, creativity, and ingenuity.[62]

Accordingly, to determine whether a covenant not to compete is valid, a court must determine whether a restriction is reasonable in the sense that it is not injurious to the public, that it is not greater than is reasonably necessary to protect the employer in some legitimate interest, and that it is not unduly harsh and oppressive on the employee.[63] An employee's post-employment anti-competitive covenant is unreasonable, and therefore unenforceable, where it is broader than necessary to protect a legitimate interest of the employer's business, in derogation of the right of the employee to practice his or her trade or profession in earning a living wherever he or she can do so, and in derogation of the right of the public to valuable or necessary services.[64]

Generally, covenants not to compete are restraints on trade and accordingly not favored. The validity of a covenant not to compete is determined by applying not only the general principles of contract construction, but also legal principles specifically applicable to such covenants. The employer bears the burden to show that the restraint is reasonable and no greater than necessary to protect the employer's legitimate business interests. The restraint may not be unduly harsh or oppressive in curtailing the employee's legitimate efforts to earn a livelihood and must be reasonable in light of sound public. As a restraint of trade, the covenant

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[61] Foti v. Cook, Jr., 263 S.E. 2d 430, 1980.

[62] Maw v. Advanced Clinical Communications, Inc., 179 N.J. 439, 846 A.2d 604, 21 I.E.R. Cas. (BNA) 471 (2004).

[63] Professional Business Services, Co. v. Rosno, 256 Neb. 217, 589 N.W.2d 826 (1999).

[64] See, generally, 54 Am. Jur. 2d, 'Monopolies, Restraints of Trade, and Unfair Trade Practices,' §§ 512, 543, 544; 2 McCarthy on Trademarks and Unfair Competition (2d ed.) § 29:12.

must be strictly construed and, if ambiguous, must be construed in favor of the employee.[65]

Nevertheless, there are certain elements that must always be considered in ascertaining the reasonableness of anti-competition covenants in employment cases. As earlier stated, reasonableness is a function of the extent of the restraint, including its territorial scope and duration, and the nature of the business or profession involved, including the employee's position and duties and the public's interest in the employee's being able to continue in that field. In practice, the courts usually weigh the relative interests of the employer and employee as the dispositive test, with most of the emphasis placed on the employer's need for protection; the public interest is a far less significant factor.[66]

Upon the other hand, the Philippine Supreme Court has ruled on the validity and enforceability of non-competition covenant employment clauses as early as 1900's citing US law and jurisprudence. In one of these early cases, it traced the progression of how courts decided cases of such nature. Said case revealed that originally the English courts viewed that any agreement which imposed restrictions upon a man's right to exercise his trade or calling was void as against public policy. But, in the course of time this opinion was abandoned and the American and English courts adopted the doctrine that where the restraint was unlimited as to both time and space it was void, but where agreements are limited as to time but unlimited as to space, or limited as to space but unlimited as to time, such covenants were valid. In recent years there has been a tendency on the part of the courts of England and America to discard these fixed rules and to decide each case according to its peculiar circumstances, and make the validity of the restraint depend upon its reasonableness. If the restraint is no greater than is reasonably necessary for the protection of the party in whose favor it is imposed it is upheld, but if it goes beyond this, it is declared void. [67]

The *Rivera* case is a portrayal of how non-competition covenants in employment contracts can be unenforceable for amounting to restraint of trade and therefore, in violation of public policy on the basis of reasonableness. It cited *Ferrazzini v. Gsell*,[68] an earlier case which extensively

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[65] Motion Control Systems v. East, 546 S.E. 2d 424, (2001).

[66] Handler & Lazaroff, 'Restraint of Trade and the Restatement (Second) of Contracts,' 57 New York University Law Review 669, 758 (1982).

[67] Ollendorf v. Abrahamson, G.R. No. 13228, Sep. 13, 1918, citing Cyc. vol. 9, at p. 525.

[68] 34 Phil. 697 (1916).

discussed public policy and restraints of trade in relation to non-competitive covenants. To quote:

> Public policy has been defined as being that principle under which freedom of contract or private dealing is restricted for the good of the community. *(People's Bank v. Dalton, 2 Okla., 476.)* It is upon this theory that contracts between private individuals which result in an unreasonable restraint of trade have frequently been declared void by the American courts. The same principle being recognized by the Civil Code, the courts of these Islands are vested with like authority.[69]

Above case further declared that in the United States, it is well settled that contracts resulting into undue or unreasonable restraint of trade are unenforceable because they are repugnant to the established public policy. In the main, there are two principal grounds on which the doctrine is founded that a contract in restraint of trade is void as against public policy. One is the injury to the public by being deprived of the restricted party's industry; and the other is the injury to the party himself by being precluded from pursuing his occupation, and thus being prevented from supporting himself and his family.

After *Ferrazzini*, another case ruled that the validity of restraints upon trade or employment is to be determined by the intrinsic reasonableness of the restriction in each case, rather than by a fixed rule, and that such restrictions may be upheld when not contrary to the public welfare and not greater than is necessary to afford a fair and reasonable protection to the party in whose favor it is imposed. The public welfare of course must always be considered, and if it be not involved and the restraint upon one party is not greater than the protection the other requires, the contract will be sustained. The general tendency of modern authority is to test whether the restraint is reasonably necessary for the protection of the contracting parties.[70]

Both *Ferrazzini* and *Ollendorf* cases adopted the enunciation made in *Gibbs v. Consolidated Gas Co. of Baltimore*[71] which stated the rule thus: "[P]ublic welfare is first considered, and if it be not involved, and the restraint upon one party is not greater than protection to the other party requires, the

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[69] Rivera v. Solidbank, 487 SCRA 512 (2006), at p. 539.
[70] Supra, at note 61.
[71] 130 US 396, (1889).

contract may be sustained. The question is, whether, under the particular circumstances of the case and the nature of the particular contract involved in it, the contract is, or is not, unreasonable." Following the aforementioned rulings, a case also decided in 1918 held that a stipulation that the employee, for a year after the termination of his contract, will not engage, for himself or others, in any business similar to that in which the employer may engage, is void as constituting an unreasonable restriction where it appears that the employer is engaged in a great variety of business enterprises, while the work of the employee was limited to a minor branch of one of them.[72]

Subsequent Philippine cases adopted the later rule of the US courts that if the restraint was limited to "a certain time" and within "a certain place", such contracts were valid and not against the benefit of the state, and that contract in restraint of trade is valid providing there is a limitation upon either time or place. A contract, however, which restrains a man entering into a business or trade without either a limitation as to time or place, will be held invalid. Also, in determining whether the covenant is reasonable or not depends on the particular circumstances of the case and the nature of business. As can be discerned from another decision,[73] a reasonable restriction as to time and place upon the manufacture of railway locomotive engines might be a very unreasonable restriction when imposed upon the employment of a day laborer.

In the most recent case of *Tiu v. Platinum Plans*,[74] the Supreme Court upheld the validity of Tiu's non-competition covenant in her employment contract with Platinum Plans. Tiu was formerly the Senior Assistant Vice-President and Territorial Operations Head in charge of its Hongkong and Asean operations of Platinum Plans for more than two years before she joined with Professional Pension Plans, Inc., as Vice-President for Sales. Upon knowing this, Platinum Plans sued Tiu for violating the non-competition covenant in her five-year employment contract stipulating that she shall not, for the next two years thereafter, engage in or be involved with any corporation, association or entity, whether directly or indirectly, which is in the same business or belonging to the same pre-need industry. Said contract likewise stated that any breach of the stipulation shall render the employee liable to the Platinum Plans in the amount of one hundred

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[72] Martin v. Glaiserman, G.R. No. 13699, Nov. 12, 1918.

[73] Del Castillo v. Richmond, G.R. No. 21127, Feb. 9, 1924, citing infra: Anchor Electric Co. v.. Hawkes, 171 Mass., 101; Alger v. Thacher, 19 Pickering [Mass.], 51; Taylor v. Blanchard, 13 Allen [Mass.], 370; Lufkin Rule Co. v. Fringeli, 57 Ohio State, 595; Fowle v. Park, 131 U. S., 88, 97; Diamond Match Co. v. Roeber, 106 N. Y., 473; National Benefit Co. v. Union Hospital Co., 45 Minn., 272; Swigert and Howard v. Tilden, 121 Iowa, 650.

[74] G.R. No. 163512, Feb. 28, 2007.

thousand pesos as liquidated damages. The trial court, Court of Appeals and the Supreme Court were all in agreement that the said non-competition covenant is valid because there is a limitation upon either time or place. The trial court found the two-year restriction to be valid and reasonable. It reasoned that Tiu entered into the contract on her will and volition. Thus, the lower court found that she bound herself to fulfill not only what was expressly stipulated in the contract, but also all its consequences that were not against good faith, usage, and law. In the same vein, the appellate court ruled that the stipulation prohibiting non-employment for two years was valid and enforceable considering the nature of Pacific Plans' business, and that a non-involvement clause is not necessarily void for being in restraint of trade as long as there are reasonable limitations as to time, trade, and place. Ultimately, the Supreme Court held that the non-involvement clause is limited as to time and also limited as to trade, since it only prohibits Tiu from engaging in any pre-need business akin to that of Platinum Plans. More significantly, the highest court in the land established that since Tiu was the Senior Assistant Vice-President and Territorial Operations Head in charge of respondent's Hongkong and Asean operations, she had been privy to confidential and highly sensitive marketing strategies of Platinum Plans' business. It further opined that to allow her to engage in a rival business soon after she leaves would make Platinum Plans' trade secrets vulnerable especially in a highly competitive marketing environment. All in all, the Supreme Court found the non-involvement clause as not contrary to public welfare and not greater than is necessary to afford a fair and reasonable protection to Platinum Plans. Not being contrary to public policy, the non-involvement clause, which Tiu and Platinum Plans freely agreed upon, has the force of law between them, and thus, should be complied with in good faith. For this reason, Tiu is bound to pay Platinum Plans the amount of P100,000 as liquidated damages. Finally, the Supreme Court said that while it has equitably reduced liquidated damages in certain cases, it cannot do so in this case, since it appeared that even from the start, Tiu had not shown the least intention to fulfill the non-involvement clause in good faith.

Applying now all the aforementioned test of reasonableness to the non-competition covenant in the *Rivera* case, it can be established that it is unreasonable under the circumstances. It is deemed as an undue restraint of trade and violative of Rivera's right to exercise his profession, and consequently, a contract stipulation that is contrary to public policy which should be declared invalid and unenforceable upon Rivera. The restraint upon Rivera to gain employment with another bank is much greater than the protection Solidbank is entitled to. As earlier indicated, Solidbank does not

even have protectable interests to speak of. Furthermore, the restraint is unduly harsh and oppressive to Rivera. Notwithstanding the presence of the retirement benefits received by him, the non-competition covenant still does not hold water. The injury to Rivera is greater in magnitude as compared to Solidbank's purported 'loss' considering that Rivera is being precluded from pursuing his occupation, and thus being prevented from supporting himself and his family. Such injury was manifested by the attachment of his family home, and the resulting mental anguish, torture and expenses incurred by the filing of the case against him. Not to be forgotten is that in light of sound public policy, it is a well-settled doctrine that in the implementation and interpretation of the provisions of the Labor Code and its implementing regulations, the workingman's welfare should be the primordial and paramount consideration,[75] and when it is apparent that the employee will suffer unwarranted hardship and loss, labor agreements should be construed strictly against the employer and in favor of the employee. Accordingly, the non-competition covenant undertaking signed by Rivera should be viewed more favorably to him than to Solidbank.

In fine, it can be said that the restraint caused by the non-competition covenant is greater than is reasonably necessary for the protection of Solidbank. On this basis, said stipulation should be stricken out as invalid and unenforceable for being a restriction of exercise of trade or profession and thus, contrary to public policy.

IX. CONTRACT OF ADHESION, UNEQUAL BARGAINING POWER BETWEEN EMPLOYER AND EMPLOYEE; AND LIBERAL INTERPRETATION IN FAVOR OF THE EMPLOYEE

A standard form contract, also referred to as an adhesion contract or boilerplate contract, is a contract between two parties that does not allow for negotiation, i.e. take it or leave it. It is often a contract that is entered into between unequal bargaining partners, such as when an individual is given a contract by the salesperson of a multinational corporation. The consumer is in no position to negotiate the standard terms of such contracts and the company's representative often does not have the authority to do so.[76]

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[75] Volshel Labor Union v. Bureau of Labor Relations, 137 SCRA 43, (1985).

[76] http://en.wikipedia.org/wiki/Contract_of_adhesion.

In Philippine cases, a contract of adhesion is one in which a party imposes a ready-made form of contract, which the other party may accept or reject, but which the latter cannot modify. One party prepares the stipulation in the contract, while the other party merely affixes his signature or his "adhesion" thereto, giving no room for negotiation and depriving the latter of the opportunity to bargain on equal footing.[77] It is not void per se but must be strictly construed against the party which drafted same.[78]

Circumstances such as the above were undeniably present when Rivera signed the undertaking. As a matter of fact, one of his allegations was that the undertaking was a contract of adhesion because it was prepared solely by Solidbank without his participation. He further claimed that because of his moral and economic disadvantage, it must be liberally construed in his favor and strictly against the bank.

It has been held that post-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power.[79] As shown in the *Rivera* case, Rivera is greatly at a disadvantage as compared with Solidbank. He does not have the equal bargaining power to negotiate with Solidbank. The undertaking is already drafted even before he voiced out his dissent to such stipulation.

Enforceability also may depend, at least in part, on whether the former employee executed the covenant on a voluntary basis. Thus, a non-competition covenant covenant has been held invalid where, among other things, former employees against whom enforcement of the covenant was sought had signed the covenant under protest after being informed that they had to sign it in order to work for the employer.[80] Said scenario is akin to Rivera's situation wherein he would not have been allowed to avail of the retirement program if he had not signed it. If this was so, his retirement benefits would not have been paid. Furthermore, there was no mention of signing such non-competitive undertaking when the retirement program was offered to employees. Thus, it can be maintained that Rivera did not voluntarily signed the undertaking for he was not given a choice to negotiate with the terms of the retirement program.

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[77] PCI Bank v. CA, G.R. No. 97785, Mar. 29, 1996.
[78] Saludo v. CA, G.R. No. 95536, Mar. 23, 1992.
[79] Restatement (Second) of Contracts, § 188.
[80] National Recruiters, Inc. v. Cashman, 323 NW2d 736 (1982, Minn).

X. VALIDITY OF NON-COMPETITION COVENANTS ATTACHED TO THE AVAILMENT OF RETIREMENT BENEFITS

Another contentious issue is with regard to the validity of a non-competition covenant when such is made as an attached condition for the availment of retirement benefits. The trial court in the *Rivera* case granted the summary judgment on the ground that the prohibition incorporated in the agreement was not unreasonable. It further declared that to allow Rivera to be excused from complying with the covenant, and at the same time benefit from the retirement plan would be to allow him to enrich himself at the expense of Solidbank. The Court of Appeals is likewise in agreement with this decision. It held that Rivera could not have availed of the retirement plan if he did not want be bound by the non-competition covenant.

Apparently, the lower court and appellate court thought that the availment of the retirement plan is a consideration for Rivera to refrain from working in another bank. But with due respect to the said courts, it has been a well-established rule that retirement plans, in light of the constitutional mandate of affording full protection to labor, must be liberally construed in favor of the employee. Retirement benefits, after all, are intended to help the employee enjoy the remaining years of his life, releasing him from the burden of worrying for his financial support, and are a form of reward for being loyal to the employer.[81] On this basis, it can be said that the long years of hard work as an employee is the real consideration for the retirement benefits and not anything else.

This holding is not only true for Philippine jurisprudence but for United States as well. In the mid-1970's, the US Congress passed the Employee Retirement Income Security Act (ERISA),[82] whose provisions were in part designed to prevent the forfeiture of certain pension benefits, notwithstanding employee competition or other misconduct. Insofar as non-competition covenant forfeiture clauses are concerned, the statute basically provides that an employee's rights in benefits derived from his own contributions are simply not forfeitable; and, an employee's rights in benefits derived from his employer's contributions are not forfeitable after specified time periods.

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[81] Rivera case, citing Sta. Catalina College v. National Labor Relations Commission, G.R. No. 144483, Nov. 19, 2003, 416 SCRA 233.

[82] 29 U.S.C.A., §§ 1001 et seq., and especially § 1053.

Even prior to the above is the holding of some US cases, that in situations where the retirement or pension plan constituted a part of the employment contract , said employer's obligation thereunder was contractual. As such, the employer is liable to pay the retiring employee his retirement benefits notwithstanding the presence of a non-competition covenant in his retirement contract. Thus, a non-competition covenant provision of this type has been ruled invalid on the ground that it violated a statutory enactment voiding contractual provisions restraining anyone from engaging in any lawful profession, trade, or business, and a retiree has been held entitled to the benefits specified by the plan, even though he accepted employment by a competitor of his former employer.[83]

In the case of *Rochester*[84] which was cited in Rivera, it was pronounced that:

> While unilateral, that offer, when accepted by an employee as evidenced by rendering services for ten or more years, became "irrevocable" and such employee acquired "a right no less contractual than if the plan were expressly bargained for." *By rendering service for the period required under the plan, the employee's rights to benefits under the plan are "earned no less than the salary paid to him (the employee) each pay period" and are "in the nature of delayed compensation for former years of faithful service."* Whether the plan is contributory or non-contributory, the benefits, thus earned, are not gratuities.
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> ...
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> The employee (under a pension plan) accepts by fulfilling the requirement that he continue in his position for a specified number of years. *At this point benefits either vest or begin to accrue as the employee continues in service or vest immediately if the employee retires.*
>
> Whether contributory or non-contributory, *pension plans are inaugurated by the employer, not as gratuities, but as instruments for providing its employees with deferred compensation* in a form that will influence its *employees to continue in its service, thereby minimizing labor turnover and securing "a more stable and a more contented labor force."* Such plans serve the interest of both employer and employee. The benefits to the employees, though deferred, are as much an item in the employee's compensation as his cash salary, xxx and the employer's payments into the pension fund are deemed tax deductible. For these reasons, the *pension plan, drafted as it normally is by the employer, is to be construed liberally in favor of the employee.* (emphasis supplied)

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[83] American Law Review, 'Validity, Construction, and Effect of Provision Forfeiting or Suspending Benefits in Event of Competitive Employment as Part of Retirement or Pension Plan,' 18 A.L.R. 3d 1246.

[84] Rochester Corporation v. Rochester, 450 F.2d 118, 1971.

Unfortunately, the *Rivera* case failed to reveal the entire tenor of the *Rochester* case which maintained that a retirement benefit once granted to the retiring employee is irrevocable because said benefit is supported not by a future event but rather, by the previous years of loyal service rendered by the employee to the employer.

The portion of the *Rochester* case that was cited in the *Rivera* case stating the validity of retirement benefit forfeiture for engaging in subsequent competitive employment, was qualified by the court. The subsequent part stated:

> It is true there are a few decisions that have found forfeiture provisions similar to that involved here invalid. *Such decisions have found support among legal commentators. They rest on the notion that pension rights are in reality earned, though deferred, compensation; and such rights to deferred compensation are not to be forfeited by restraints on competition, which, either in time or geography, are not "reasonable in the light of the interests protected." This case, however, was based on a California statute rather than common law. (emphasis supplied)*

It appears from the foregoing that it is inaccurate to establish in the *Rivera* case that *Rochester* ruling actually supplanted the strong weight of authority in favor of non-forfeiture of retirement benefits. The reason for the court's contrary decision is the presence of the statutory provision specifically allowing the forfeiture in cases when the former employee engaged or is employed in a competitive business. The court went as far as to say that the District Court correctly concluded that the defendant's rights to the pension plan could not be prejudiced by the statute's amendment on July 21, 1960; nevertheless, the District Court erred in concluding that the plaintiff was entitled to retirement benefits accruing on account of services after the effective date of the amendment of 1960. Thus, it is revealed that without the amendment of the law, the employer is entitled to the full amount of the retirement benefit despite the fact that he violated the non-competition covenant.

In fine, once an employee, who has accepted employment under the established retirement benefit plan, and has complied with all the conditions entitling him to participate in such plan, his rights become vested and the employer cannot divest the employee of his rights thereunder.[85] This is the plain and simple intention of the law that confers retirement benefits to employees.

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[85] Puma v. Brandenburg (D.C.N.Y.1971) 324 F.Supp. 536, 544; Cantor v. Berkshire Life Ins. Co., 171 N.E.2d 518, 522.

XI. CONCLUSION

Restrictive covenants which tend to prevent an employee from pursuing a similar vocation after termination of employment are generally not favored by the law. Anti-competitive employment agreements should be enforced only to the extent necessary to protect the employer from unfair competition such as employee's use or disclosure of trade secrets or confidential customer lists or where the employee's services are unique.

Nevertheless, as can be concluded from the foregoing discussion, such covenants will be enforced where they meet the following test: (1) the restraint is reasonably necessary to protect the employer's business, (2) it is not unreasonably restrictive of the employee, and (3) the covenant is not antagonistic to the general public. Furthermore, an employer must demonstrate some special facts giving his former employee a unique competitive advantage or ability to harm the employer before the employer is entitled to the protection of a non-competition covenant covenant; those special facts may include, but are not limited to, such things as trade secrets known by the employee, the employee's unique services, confidential information such as customer lists known to the employee, or the existence of a confidential relationship.

In situations where the non-competition covenant is made as an attached condition in order to avail of retirement benefits, the *Rochester* case has pronounced that retirement benefits once vested to the employee is no longer subject to forfeiture even with the existence of a non-competition covenant. As earlier stated, the retirement benefit is not in consideration of the employee's abstaining from working for a competitor but rather, by the previous years of loyal service rendered by the said employee to his former employer.

In the end, the task of determining the validity of non-competition covenants is one of balancing competing interests, for which there can be no mathematical formula. There is no arbitrary measurement of what protection is reasonably necessary for an employer's business, no categorical measurement of what constitutes undue hardship on the employee, and no precise scales to weigh the interest of the public. Each case must be determined on its own particular facts, and it is impossible to lay down a universal rule. The same identical contract and restraint may be reasonable and valid under one set of circumstances, and unreasonable and invalid under another set of circumstances. Indeed, what is of paramount

importance is that courts of justice shall always rule on the basis of law, fairness, equity and justice.

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