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Contracts - Covenants Not to Compete

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RECENT DECISIONS

Contracts — Covenants not to Compete — The plaintiff, a barber supply company, employed the defendant in 1945 as as salesman in the states of North and South Carolina, and "particularly in the eastern parts of said states." The defendant, at the time of his employment, contracted upon termination of employment:

> "Not to own, operate any company or business selling same type of merchandise in the stipulated territory (states of North and South Carolina and particularly in the eastern part) for a period of 5 years . . . not to contract any account handling this same type of merchandise either in person or in writing or by telephone, and by acceptance of employment under contract."

The defendant terminated the contract in 1947 and subsequently entered the employment of a competitor of the plaintiff who carried on a similar business in the same area. The defendant even solicited trade from the buyers he had sold goods to while in the plaintiff's employ. The plaintiff attempted to enjoin the defendant from soliciting in the stipulated area. The defendant raised the defense that this was an unreasonable restraint of employment and consequently void. Plaintiff failed to prove that its area of established business was as great as the area of contract restriction. *Held:* the contract area of restriction was unreasonable because plaintiff had failed to prove an established business commensurate with the contract area. The Court refused to sustain the restriction even insofar as the area of plaintiff's established business or the area of defendant's personal contacts, thus rejecting the doctrine of severability. *Noe v. McDevitt, 45 S.E. (2d) 121 North Carolina, (1948).*

Early common law held such restrictive covenants void prima facie as a restraint of trade, until the *Reynolds*[1] case distinguished between total and partial restraints of trade. The latter were permissible if based upon good consideration, not contrary to public policy, and ancillary to sale of business or dissolution of a partnership.[2] Today, negative covenants in restraint of employment are treated as a partial restraint of trade. However, there is a growing tendency in the courts to adopt the English distinction between covenants in partial restraint of trade and those in restraint of employment.[3] The latter the courts are reluctant to enforce.[4]

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[1] Mitchell v. Reynolds, I.P. Wms. 18 (1711), where the covenant at issue was declared void but the distinction was laid down.

[2] Williston, Contracts, (Rev. Ed.) sec. 1637 (1937); Coker v. Rickey, 104 Ore. 14, 202 P. 551, 22 A.L.R. 744 (1921).

[3] Samuel Stores v. Abrams, 94 Conn. 248, 108 A. 54, 9 A.L.R. 145 (1919); Granger v. Craven, 159 Minn. 296, 199 N.W. 101, 52 A.L.R. 1356 (1919); McCleur v. Super Maid Cook Ware Corp., 62 F.(2d) 426 (1926), where Taft

The judicial enforceability of negative covenants in restraint of employment is now generally determined by the test of reasonableness.[5] The courts consider three major factors in applying the test: (1) the right and necessity of the employer's protection of his business from the employee; (2) the restraint of the employee's right to earn a livelihood; and (3) the effect upon the public.[6] Wisconsin seems to consider the probability of the employee becoming a public charge as controlling in some instances.[7] It is well settled that where the restraint unreasonably exceeds the necessary requirements it is void for that reason alone.[8] The old common law requirement of definite limitations as to space and time is now disregarded if the restraint is reasonable under the above three factors.[9]

The test of reasonableness generally turns on the area or the territory from which the employee is restrained.[10] If an employee has acquired knowledge in the nature of a trade secret,[11] or if the covenant accompanies a sale of a business or dissolution of a partnership,[12] the majority rule determines the area of reasonable restraint to be the area of established business, and if the covenant exceeds this area it will not be enforced.[13] In cases where a salesman is involved, unless he uses

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J. lays down all permissible restraints of trade in which he includes restraints of employment:

1. Any seller of property or business not to compete with buyer in such a way as to derogate from the value of the property or business sold.
2. Any retiring partner not to compete with the existing firm.
3. Any partner pending partnership not to do anything to interfere by competition or otherwise with the firm or business.
4. Any buyer of property not to use the same in competition with business retained by seller.
5. Any assistant, servant or agent not to compete with his master or employer, at expiration of his service.

[4] Annotation, 152 A.L.R. 415 (1944) discusses the problem and lists cases both ways.

[5] Restatement of Contracts sec. 515, 516, 517, (1932); Kadis v. Britt, 29 S.E.(2d) 543, 152 A.L.R. 405 (1944); Mil. Linen Supply Co. v. Ring, 210 Wis. 467, 246 N.W. 567 (1933), adopts the reasonable test laid down by the Restatement; Heckard v. Park, 164 Kan. 216, 186 P.(2d) 936, 175 A.L.R. 605 (1948).

[6] Grand Union Tea Co. v. Walker, 218 Ind. 245, 195 N.E. 277, 98 A.L.R. 958 (1938); Milgram v. Milgram, 105 Ind. App. 57, 12 N.E.(2d) 394 (1938); Tobacco Growers Co-op v. Jones, 185 N.C.(2d) 265, 33 A.L.R. 958 (1924); Mil. Linen Supply Co. v. Ring, note 5, *supra.*

[7] Mil. Linen Supply, note 5, *supra;* 18 Iowa L. Rev. 546 (1932); 17 Marq. L. Rev. 94 (1932); 9 Wis. L. Rev. 14 (1933).

[8] Restatement, note 5, *supra,* sec. 514, 515(b); Metropolitan Ice Co. v. Ducas, 291 Mass. 176, 196 N.E. 856, noted 15 B.U. L. Rev. 834 (1935); 22 Va. L. Rev. 94; Horner v. Graves, 7 Bing. 735 (1851), wherever restraint is larger than necessary for protection of a party it is unreasonable and consequently void.

[9] Williston, note 2, *supra,* sec. 1639 for authorities.

[10] 29 Ky. L. J. 110, (1940) discusses the test of reasonableness as to territory.

[11] Restatement of Agency, sec. 396 (1933), as to the knowledge of agent of the principal's business; Williston, note 2, *supra,* sec. 1643, note 4.

[12] General Bronze v. Schmeling, 208 Wis. 565, 245 N.W. 589 (1932) that on a sale of the business restraint is reasonable to the extent of the business good will, and may be nation-wide; Annotation 94 A.L.R. 345 (1934).

[13] Williston, sec. 1646, note 7, *supra.*

written customer lists or possesses knowledge in the nature of trade secrets,[14] he is placed in the category of a mere servant and the majority rule will not permit him to be restricted. Thus, if the employer cannot prove both that his employee possesses trade secrets and that the contract area is limited to the area of established business, he will be left without remedy. The doctrine of severability does not save the covenant to any extent because if the court finds that the employee does not possess knowledge so as to endanger the employer's business, the employer has nothing to fear from the employee in any area. The doctrine of severability could be applied where there is special knowledge and the contract area exceeds the established business area, but the courts refuse to save the covenant to the extent of the established business unless the contract terms provide a basis for severability, being reluctant to remake the contract.[15]

New York and Wisconsin recognize an intermediate ground in employment restrictions of salesmen and solicitors, where a personal relationship exists between the employer's customers and the salesmen. In these cases the theory is that the sales follow the salesman and the employer needs protection to the extent of the employee's activities. New York holds that such covenants are independent and will enforce them almost in any case where the employer shows need of such protection and has exacted such a covenant from his employee.[16] Wisconsin also recognizes this personal relationship and states explicitly that such a restraint is reasonable to the extent of the employee's activities.[17] In cases where the contract area exceeds the area of the salesman's activities Wisconsin will sever it so as to make it reasonable and give the employer necessary protection. It is therefore clear that the personal contact rule permits the employer to restrict the salesman or solicitor from doing business with customers after he has terminated his employment.

The North Carolina court in attempting to apply the majority rule in the principal case disregards the personal relationship existing between the salesman and the employer's customers and the necessity of protecting the employer's business from this personal contact, leaving

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[14] Cases collected pro and contra in 54 A.L.R. 343 (1928).

[15] 9 Wis. L. Rev. 310 (1934), discusses the doctrine of severability as applied to covenants in restraint of employment.

[16] Briggs v. Clover, 254 App. Div. 619, 3 N.Y.S. (2d) 79 (1938), where employee was hostess and solicited contracts from customers; 9 A.L.R. 1146 (1919) equity cases where employee was restrained because he gained knowledge and personal contact with the customers; Love v. Miami Laundry Co., 118 Fla. 137, 160 So. 32 (1935).

[17] Wisconsin Ice and Coal v. Leuth, 213 Wis. 42, 250 N.W. 819 (1933), Wickem J. "It is generally proper for the employer, to exact a covenant not to compete in such territory as may constitute the field of the employee's activities, but the covenant can go no farther."

the employer without remedy at law or in equity. The personal contact rule seems to be the better reasoned rule and more desirable for it recognizes and protects the economic interests of both the employer and the employee.

EARL A. CHARLTON

Taxation — Cancellation of Gift for Mistake of Law — Plaintiff made a gift to his wife of stock in a corporation that he and another controlled. Subsequently, the corporation was dissolved and a limited partnership of husbands and wives was formed to which each conveyed an undivided interest in the tangible assets received by them in the liquidation. In 1942, the Commissioner of Internal Revenue assessed the income received by the wife from the partnership to the plaintiff, and the position of the Commissioner was sustained by the courts.[1] Plaintiff then sought to have the gift rescinded in equity on the ground that it was made under a mistaken interpretation of the income tax law. *Held:* that plaintiff made the gift to his wife for the purpose of creating a separate estate in her name as well as for its tax-saving effect, and under such circumstances a court of equity will not rescind the gift. *Lowry v. Kavanaugh, et al, 34 N.W. (2d) 60 (Michigan, (1948).*

The plaintiff relied on a previous Michigan decision in *Stone v. Stone*[2] where the court allowed rescission of a similar gift made in a misguided effort to save taxes. In that case, parents transferred in trust for their minor children undivided shares in a family partnership believing that the income arising thereon would be taxed separately to the children for federal income tax purposes. The *Stone* decision seemed quite liberal, but the Court in the instant case distinguished it on this ground: in *Stone* the only purpose of the gift was the expected tax saving, whereas in the present case the main purpose was to create a separate and independent estate in the wife, the tax-saving motive being only secondary. The Court in the *Stone* case, after reviewing the facts, concluded that there was involved "no compromise of doubtful legal rights, no question of the rights to retain the benefits of a bargain, and no circumstance making restitution inequitable to the donees or inexpedient because opposed to public interests". In the instant case, the Court reasoned that there were circumstances which would make restitution inequitable. The donor in his testimony stated that he made this gift because he wanted his wife to have property of her own independent of his, which she could do with as she pleased. To return

[1] Tower v. Commissioner, 327 U.S. 280, 66 S. Ct. 532, 90 L. Ed. 670, 164 A.L.R. 1135 (1946).
[2] Stone v. Stone, 319 Mich. 194, 29 N.W.(2d) 271 (1947).