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COVENANTS NOT TO COMPETE: THEIR USE AND ENFORCEMENT IN INDIANA

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I. INTRODUCTION

As American businesses evolve from being industry driven to being more service oriented, and the number of employees changing from one job to the next becomes more common, the need and desire for employers to protect their interests becomes more pronounced. For these reasons, covenants not to compete, whether ancillary to an employment contract, or ancillary to the sale of a business, or standing alone, have become important business documents in the workplace.¹ In the absence of such a covenant, an employee may be able to compete directly with the employer after the employment affiliation has ended, and may be able to utilize the employer's confidential information while the employer has little or no recourse.²

A covenant not to compete is, broadly speaking, used in two situations: first, in, or ancillary to, an employment contract, or second, in connection with the sale of a business. Indiana courts have treated these two uses quite differently and have applied separate standards with regard to their enforcement. This Article addresses covenants not to compete under Indiana law ancillary to both

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1. Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 652 (1960).

2. Robert W. Sikkel & Louis C. Rabaut, *Michigan Takes a New Look at Trade Secrets and Non-Compete Agreements*, 64 MICH. B.J. 1069, 1070 (1985).

the employer/employee relationship³ and the sale of a business.⁴ The Article discusses the history of covenants not to compete,⁵ the reasonableness standard,⁶ an employer's or buyer's protectible interests,⁷ geographic limitations,⁸ time limitations,⁹ and severability.¹⁰ Finally, the Article discusses drafting techniques¹¹ and litigation issues.¹²

II. COVENANTS NOT TO COMPETE BETWEEN EMPLOYERS AND EMPLOYEES

A. *The History of Covenants Not to Compete Ancillary to Employment Contracts Under Indiana Law*

Covenants not to compete in employment contracts have been the basis for litigation since before the discovery of America.¹³ In Indiana, the first significant case involving a covenant not to compete ancillary to an employment contract occurred in 1858.¹⁴ Despite, or perhaps because of this long legal history, covenants not to compete still present vexing and complicated issues, often resulting in ambiguous and confusing precedent. This legal confusion stems at least in part from the tension between a person's freedom to contract and the public policy which invalidates restraints on trade.¹⁵ If the employer seeks a covenant not to compete solely to restrain competition, it will be struck down because "it tends to [result in] a monopoly."¹⁶ Accordingly, the covenant not to compete must anticipate a possible injury the employer would suffer at the hands of a former employee, as opposed to merely preventing an employee from competing in the workplace in the future.¹⁷

3. See *infra* text accompanying notes 13-115.

4. See *infra* text accompanying notes 116-42.

5. See *infra* section II. A., III. A.

6. See *infra* section II. B.

7. See *infra* section II. C., III. B.

8. See *infra* section II. D., III. C.

9. See *infra* section II. E., III. D.

10. See *infra* section II. F., III. E.

11. See *infra* section IV.

12. See *infra* section IV.

13. Blake, *supra* note 1, at 631.

14. *Duffy v. Shockey*, 11 Ind. 70 (1858) (holding that where a contract in restraint of trade is not general, but applies only to a particular person, within prescribed and reasonable limits, it will be enforced).

15. Peter J. Whitmore, *A Statistical Analysis of Noncompetition Clauses in Employment Contracts*, 15 J. CORP. L. 483, 486 (1990).

16. *Milgram v. Milgram*, 12 N.E.2d 394, 395 (Ind. Ct. App. 1938) (citing *Horner v. Graves*, 131 ENG. REP. 284 (1831)).

17. *Field v. Alexander & Alexander of Ind., Inc.*, 503 N.E.2d 627, 632 (Ind. Ct. App. 1987).

It is the very act of deciphering each unique set of factual circumstances and attempting to apply the broad strokes of ideals like "reasonableness" and "restraints on competition" that so complicates the inquiry into restrictive covenants. In fact, there are alarmingly few bright line rules draftsmen can look to for guidance. The most any draftsman can hope for is to understand the general principles so as to be able, with a healthy dose of intuition, to utilize them effectively. What follows is an attempt to lay the groundwork for understanding how Indiana courts treat this subject.

B. The Reasonableness Standard

The basic principles regarding the reasonableness of a contract in restraint of trade are stated by Professor Samuel Williston in his treatise on contracts:

It is uniformly agreed that in order to be valid a promise imposing a restraint in trade or occupation must be reasonable. . . . The question of reasonableness is ordinarily for the court, not the jury; however, there are at times mixed questions of law and fact identified with what is a reasonable restraint in a given agreement. In considering what is reasonable, regard must be paid to: (1) The question whether the promise is broader than is necessary for the protection of the covenantee in some legitimate interest; (2) The effect of the promise upon the covenantor, and (3) The effect of the promise or agreement upon the public welfare or common good.¹⁸

Although the question of "reasonableness" is deemed to be one of law and, thus, for the courts to decide, it must be decided based upon the facts and circumstances surrounding each case. Thus, the student of restrictive covenants is confronted with an anomaly: although the question of reasonableness is ultimately one of law, it is premised upon the facts existing as of the date of attempted enforcement.¹⁹

Indiana courts, like those of most states, adopted Williston's reasonableness standard for judging restrictive covenants. Illustrative is *Donahue v. Permacel Tape Corp.*,²⁰ in which the court stated that a covenant is considered valid and reasonable if the following three criteria are met: first, the restraint is reasonably necessary to protect the employer; second, the restraint is not unreasonably

18. 14 SAMUEL WILLISTON, WILLISTON ON CONTRACTS § 1636, at 88-93 (Walter H. E. Jaeger ed., 3d. ed. 1972).

19. *Frederick v. Professional Bldg. Maintenance Indus.*, 344 N.E.2d 299, 301 (Ind. Ct. App. 1976).

20. 127 N.E.2d 235 (Ind. 1955).

restrictive of an employee; and, third, the restraint does not violate public policy.²¹

In making a determination of reasonableness, a court will first consider the business interests of the employer which might be protected by the covenant. The court will then examine the employer's proffered business interests so as to determine whether the duration, the geographic area, and the types of activity proscribed by the covenant are reasonable.²² "It is the interrelation of the considerations of protectible interest, time, space, and proscribed activity that make a particular covenant reasonable or unreasonable."²³

C. An Employer's Protectible Interest

Before a court can enforce a covenant, it must know why the covenant was needed. In other words, the employer must define what its interests are that require protection via a restrictive covenant. The court must then determine whether the proffered reasons are reasonable under the circumstances.²⁴ Valid reasons include an employer's use of a restrictive covenant to preserve such property rights as good will, trade secrets, and confidential information.²⁵

"Good Will" is defined to include: names, addresses, and requirements of customers; price information; and the advantageous familiarity and personal contact which the employees derived from their dealings with customers.²⁶ Confidential information is defined to mean information not generally known outside the employer's company, which relates to the employer's business, and is disclosed to or known by the employee as a consequence of, or through, his

21. *Id.* at 239.

22. 4408, Inc. v. Losure, 373 N.E.2d 899, 900 (Ind. Ct. App. 1978).

23. *Frederick*, 344 N.E.2d at 302. The court in *Frederick* went on to say that "[t]his is true even though in a given case the breadth of a single restriction may appear to dominate the outcome." *Id.*

24. *Captain & Co., Inc. v. Towne*, 404 N.E.2d 1159, 1161 (Ind. Ct. App. 1980).

25. *Id.* at 1162.

26. *Losure*, 373 N.E.2d at 901. Here, Losure, as a salesman for 4408, Inc., personally sold about seventy percent of the firm's accounts, or seven hundred accounts. Losure's duties as Sales Manager included soliciting new accounts, maintaining the old ones, and creating good will. The court held that this familiarity with customers and their accounts was an interest that would justify a protectible interest for the employer. *Id.* See also *Donahue v. Permacel Tape Corp.*, 127 N.E.2d 235 (Ind. 1955). In *Donahue*, the court stated that elements of good will include names, addresses and requirements of customers and the advantage acquired through representative contact with the trade in the area of their application. *Id.* at 240. "These are property rights which the employer is entitled to protect." *Id.*

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or her employment.²⁷ Finally, trade secret is defined by the Indiana Uniform Trade Secrets Act to mean

information, including a formula, pattern, compilation, program, device, method, technique, or process that: (1) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.²⁸

The definition of trade secrets is further supplemented by the Restatement of Torts, which provides that a "trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."²⁹

In *Ackerman v. Kimball International, Inc.*,³⁰ the court examined whether the employer's supplier list, customer list and pricing data constituted trade secrets sufficient to justify enforcement of a restrictive covenant.³¹ The court held that Kimball's supplier list, customer lists, and pricing data constituted "information" which derived independent value and which were not "readily ascertainable," because the information was not commonly known or available outside of Kimball's business and because the information was difficult for Kimball's competitors to obtain.³² The court found such "independent value" because Kimball's competitors would benefit either by obtaining a "competitive edge" or "some advantage" from acquiring the pricing, supplier or customer information.³³ Therefore, the court held that the supplier list, customer list, and pricing data were trade secrets.

27. 2 LOUIS ALTMAN, CALLMANN ON UNFAIR COMPETITION, TRADEMARKS & MONOPOLIES § 14.11-12 (4th ed. 1982).

28. IND. CODE ANN. § 24-2-3-2 (West 1995). To have a protectible trade secret the following four criteria must be met: (1) the trade secret must consist of information; (2) the information must derive independent economic value; (3) the information must not be generally known, or readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use; and (4) reasonable efforts, under the circumstances, must have been made to maintain the information's secrecy. *Id.*

29. RESTATEMENT OF TORTS § 757 cmt. b (1939).

30. 634 N.E.2d 778 (Ind. Ct. App. 1994).

31. *Id.* at 780.

32. *Id.* at 782-83. Kimball also took reasonable efforts to keep secret the supplier list, customer list, and pricing data. *Id.*

33. *Id.*

Not all employer interests are protectible by a restrictive covenant. The skill the employee has obtained from the employer, or the basic knowledge or experience the employee has acquired by working for the employer, which is not directly associated with the good will or value of the employer's business, is considered a non-protectible interest.³⁴ Therefore, when the employer/employee relationship is terminated, the employee has a right to take the skills or knowledge gained from the employment with him or her (with the exception of trade secrets or confidential information).³⁵ Even in the absence of a restrictive covenant, an employee may not use trade secrets or confidential information against his or her former employer.

It is often difficult, however, for an employer to establish that it did in fact invest the employee with trade secrets or confidential information. In *American Shippers v. Campbell*,³⁶ American Shippers, an Ohio corporation, maintained an office in Indianapolis, Indiana. The company sold shipping room supplies and equipment in a very tight and extremely competitive market. The defendant, Campbell, was an employee of American Shippers. He was responsible for soliciting sales for supplies and equipment for the entire state of Indiana. Campbell later resigned and began working for a competitor of American Shippers. There was evidence that Campbell misappropriated information contained on customer file cards and that he informed former customers of American Shippers that he was no longer with the company and was working for a competitor.

Contrary to the *Ackerman* court, the *American Shippers* court found that the customer lists were not confidential and not protected because they could be acquired through a telephone book or trade publication.³⁷ Actually, because the customer file cards were readily available to all American Shippers employees, the information contained on the cards was not regarded as confidential.³⁸ Despite the fact that American Shippers engaged in the sale of non-unique products, it argued that Campbell should be bound by the covenant because American Shippers' business depended on the personal service performed by its salespersons.³⁹ The court, while acknowledging that there are cases where the highly personalized nature of the contract between a salesperson

34. *Donahue v. Permacel Tape Corp.*, 127 N.E.2d 235, 240 (Ind. 1955). Note, however, that the knowledge of trade secrets and confidential information is still a protectible employer interest. *Id.*

35. *Id.* Consequently, an employee may contract to conditionally waive these individual achievements as consideration for his or her employment only where their use, adverse to the employer, would result in irrevocable impairment to the employer. *Id.*

36. 456 N.E.2d 1040 (Ind. Ct. App. 1983).

37. *Id.* at 1044.

38. *Id.*

39. *Id.* at 1043-44.

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and customers can create a protectible interest on behalf of an employer, rejected American Shippers' assertion that such an interest was created.⁴⁰ The court noted that no personal relationship existed between Campbell and American Shippers' clientele, that American Shippers' customers did not depend on any special skill or knowledge utilized by Campbell, and that American Shippers' customers did not care about the salespersons with whom they dealt, but were only concerned with the product they were purchasing.⁴¹ The court held that when a customer list does not constitute confidential information, the employer must demonstrate some other protectible interest in the information.⁴²

American Shippers is instructive to employers who require or have contemplated requiring their employees to execute restrictive covenants. It is not enough to pay lip service to the idea of confidentiality. If information can be easily duplicated or acquired, it is probably not confidential. In the absence of confidential information or trade secrets, an employer must be able to establish some other "protectible interest" sufficient to justify a restraint on competition. The fact that an employee performed his or her job and performed it well is not enough to prohibit the employee from competing once the employment has ended. The employer must be able to establish something more because "unsubstantiated claims of '[h]ighly specialized training and personal supervision in connection with the sales of ordinary merchandise well known in the market . . . are statements too general in nature to constitute ground[s] for legal relief.'"⁴³

40. *Id.* at 1044.

41. *American Shippers Supply Co. v. Campbell*, 456 N.E.2d 1040, 1044 (Ind. Ct. App. 1983). *Miller v. Frankfort Bottle Gas, Inc.* is distinguishable because the court in *Miller* found a protectible interest where the employee, a salesman, had a personal relationship with the employer's customers, and the customers stopped doing business with the employer when the employee was terminated by the employer. *Miller v. Frankfort Bottle Gas, Inc.*, 202 N.E.2d 395, 398 (1964). Another factor the court in *Miller* used to determine that there was no protectible interest was the fact that a loss of customers was very unusual in the bottled gas industry. *Id.*

42. *American Shippers Supply Co.*, 456 N.E.2d at 1045. The court noted that in most cases customer lists are regarded as confidential information. *Id.* at 1044. However, the court cited *Licocci v. Cardinal Assoc., Inc.*, in which the *Licocci* court found that

[a]lthough Cardinal Associates may have considered its customer lists confidential, no evidence indicated these lists could have been used to undercut competition or could not easily have been duplicated by alternate means, such as a telephone canvass of the market area. Neither was there evidence the information given salesmen was novel or unique to Cardinal Associates so as to constitute a protectible trade secret.

Licocci v. Cardinal Assoc., Inc., 445 N.E.2d 556, 561 (Ind. 1983).

43. *American Shippers Supply Co.*, 456 N.E.2d at 1044 (citing *Club Aluminum Co. v. Young*, 160 N.E. 804, 806 (Mass. 1928)).

D. Geographic Limitations

In order to be enforceable, the geographic limitation contained in a restrictive covenant must be confined to what is "reasonably necessary" to protect the employer's interests.⁴⁴ Accordingly, courts will find a geographic limitation invalid if the restriction reaches beyond what is necessary to protect the employer's business interests.⁴⁵ However, there is an exception to the general rule of having a specific time limitation in a restrictive covenant. In *Ebbeskotte v. Tyler*,⁴⁶ the court explained this exception. There, the restrictive covenant did not have a time restriction and did not restrict the employee from working in the same area where the employer was established.⁴⁷ The covenant only restricted the employee from soliciting and accepting employment directly or indirectly from the employer's clients.⁴⁸ The court held that even though the restrictive covenant was unlimited as to duration, it was narrowly limited in geographical area and was therefore enforceable.⁴⁹ The applicable question is what is necessary to protect the employer. In this sense, it is really impossible to separate the discussion of geographic restrictions from that of the employer's interest in prohibiting competition. Nevertheless, it is possible to draw some generalizations.

A geographic limitation extending to the full extent of the employer's business activity is rarely enforceable. Most reported decisions in Indiana allow the covenant to extend only to those areas in which the employee has actually performed work for the employer. *Ackerman v. Kimball International, Inc.*,⁵⁰ however, illustrates an exception to this rule. In *Ackerman*, the court enforced a reasonable covenant which restricted the employee from using or disclosing

44. 4408, Inc. v. Losure, 373 N.E.2d 899, 902 (Ind. Ct. App. 1978).

45. *Mantek v. Share Corp.*, 780 F.2d 702 (7th Cir. 1985) (restrictive covenant was not limited to customers and potential customers with whom the employee had contact while working for the employer); *Schlumberger Well Serv. v. Blaker*, 623 F. Supp. 1310 (S.D. Ind. 1985) (the entire North American continent); *Cap Gemini Am., Inc. v. Judd*, 597 N.E.2d 1272 (Ind. Ct. App. 1992) (all states in which the employer does business; Indiana, Kentucky, and Ohio); *Commercial Bankers Life Ins. Co. v. Smith*, 516 N.E.2d 110 (Ind. Ct. App. 1988) (same); *College Life Ins. Co. v. Austin*, 466 N.E.2d 738 (Ind. Ct. App. 1984) (no geographic limitation and no sufficient class of people); *Frederick v. Professional Bldg. Maintenance Indus.*, 344 N.E.2d 299 (Ind. Ct. App. 1976) (eight counties, when employee did not work in all eight counties).

46. 142 N.E.2d 905 (Ind. Ct. App. 1957).

47. *Id.* at 907.

48. *Id.* at 909.

49. *Id.* The court supported its argument using *O'Neal v. Hines*, which stated that "a contract, reasonably limited as to the territory in which the specific business is not to be carried on, is not rendered invalid because the restriction as to time is indefinite or general." *O'Neal v. Hines*, 145 Ind. 32, 35 (1895).

50. 634 N.E.2d 778 (Ind. Ct. App. 1994).

confidential information to the full extent of the employer's business.⁵¹ The plaintiff signed an agreement which provided that Kimball would continue Ackerman's employment in exchange for Ackerman's promise not to compete, directly or indirectly, with Kimball for one year following his termination.⁵² The covenant contained no geographic limitation. At the time he signed the covenant, Ackerman was an executive Vice-President at Kimball and oversaw the operations of the company's plants.

Ackerman was subsequently demoted to general manager of a single plant and managed the day-to-day operations of that plant. Despite his demotion, Ackerman had in his possession a comprehensive supplier list, a customer list, and pricing data for the Evansville, Indiana plant. In 1993, he was terminated by Kimball. He later signed a termination agreement, agreeing not to use Kimball's trade secrets.⁵³ Shortly thereafter, Kimball discovered that Ackerman was looking for employment with competitors of Kimball.

After acknowledging that Ackerman was in possession of trade secrets, the court addressed the issue of whether the lack of a geographic limitation rendered the restrictive covenant invalid.⁵⁴ The court held that when an employee obtains or is entrusted with the trade secrets of his employer, that employee may enter into a valid covenant with the employer which forbids the employee from "the competitive use or disclosure of such trade secrets to the full extent of the affected area of the business of the employer."⁵⁵ Accordingly, a restrictive covenant that prohibits the employee from using or disclosing trade secrets is not invalid simply because it limits the competitive employment of an employee

51. *Id.* at 782.

52. *Id.* at 781. The Employment Agreement provided as follows:

1. Employer agrees to employ or continue to employ Employee at the salary or wage as now or from time to time agreed on. Nothing herein contained shall affect the right of either party to terminate Employee's employment with Kimball International, Inc. at any time
3. Employee agrees that he will carefully guard and keep all information, knowledge or data of Employer or of any customer of Employer which Employee may obtain during the course of his employment, and further agrees that he will not disclose at any time any such information, knowledge or data of Employer or any customer of Employer to others, except such information, knowledge or data as may be generally known to the public.
4. Employee agrees that he will not, without prior written consent of Employer, either during the period of his employment or within one year after the termination thereof, become directly or indirectly engaged in inventing, improving, designing, developing or manufacturing, any products directly competitive with the products of Employer.

Id.

53. *Id.* In return for signing the termination agreement, Kimball gave Ackerman a "transitional salary allowance" of \$15,000.00 and other benefits. *Id.*

54. *Id.* at 782.

55. *Id.* (citing *Donahue v. Permacel Tape Corp.*, 127 N.E.2d 235, 237 (Ind. 1955)).

beyond the area of his or her former employment.⁵⁶ *Ackerman* may be read as standing for the proposition that, despite the absence of a geographic limitation in a covenant, the covenant may still be reasonable and enforceable.

Aside from establishing possession of trade secrets, it is possible to draft an enforceable covenant without specifying a specific geographic scope. This can be done by increasing the specificity of the class of persons with whom contact is prohibited. With this done, the need for a limitation expressed in territorial terms decreases.⁵⁷ Therefore, using this approach, if the limitation of the class of people is specific enough, no geographic limitation is needed.⁵⁸

It should be noted that meeting this specificity requirement may be difficult. In *Commercial Bankers Life Insurance Co. v. Smith*,⁵⁹ the Indiana Court of Appeals held that the covenant not to compete was invalid because it did not contain defined, geographic boundaries, *and* the class of persons with whom contact was prohibited was not well defined.⁶⁰ The court found that the only geographic limitation in the covenant, which Smith signed, restricted him from

56. *Ackerman v. Kimball Int'l Inc.*, 634 N.E.2d 778, 782 (Ind. Ct. App. 1994). Similarly, in *Waterfield Mortgage Co., Inc., v. O'Connor*, the court stated:

[W]here an employee is not privy to confidential information, a covenant restricting his employment beyond the area of his former employment is unreasonable. However, if an employee obtained confidential information, he may be restricted in the competitive use and disclosure of such information to the full extent of the employer's business which is thereby affected.

Waterfield Mortgage Co., Inc., v. O'Connor, 361 N.E.2d 924, 927 (Ind. Ct. App. 1977).

57. *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 213 (Ind. Ct. App. 1982).

58. *Field v. Alexander & Alexander of Ind., Inc.*, 503 N.E.2d 627, 629 (Ind. Ct. App. 1987).

The covenant at issue in *Field* consisted of the following:

In consideration of the Corporation entering into this agreement, which you accept by your signature below, and for other good and valuable consideration, you agree that if your employment with the Corporation or any of its subsidiaries or affiliates should terminate for any reason, you will not, for a period of two years after that date of such termination, in any capacity whatsoever (including, but not limited to, as an employee, officer, director, stockholder, proprietor, partner, joint venturer, consultant or otherwise), directly or indirectly, solicit, sell, service, divert, accept or receive insurance agency, brokerage or consulting business or actuarial or employee benefits (Benefacts) business, or property tax consulting business, from, or to, any customer or active prospect of the Corporation, or any of its affiliates or subsidiaries, which you personally, alone or in combination with others, handled, serviced or solicited at any time during the two year period immediately preceding termination of your employment.

Id.

59. 516 N.E.2d 110 (Ind. Ct. App. 1987).

60. *Id.* at 113.

"directly or indirectly competing within the area of his responsibility."⁶¹ The court concluded that under Indiana law a court cannot rewrite a restrictive covenant, and since the restrictive covenant contained no geographic limitations or defined any geographic boundaries, the restrictive covenant was void and unenforceable.⁶² In order for the *Smith* court to have found a valid restrictive covenant without a geographic limitation, the covenant must have only restricted Smith from contacting customers with whom Smith had contact during his employment with Commercial Bankers.⁶³

Absent a showing that the employee was entrusted with confidential information, the great weight of authority in Indiana allows geographic limitations to extend only as far as the area in which the employee has worked, or in which the employee has made customer contact.⁶⁴ By way of example, in *4408, Inc. v. Losure*,⁶⁵ the covenant's scope did not exceed the employee's area of work but prohibited him from competing in all counties where he had worked.⁶⁶ The court held that the restrictive covenant's geographic limitation was valid and reasonable.⁶⁷

Professionals, such as doctors, have often presented vexing business and ethical concerns to Indiana courts when their former employers or partners seek to restrict their access to patients or clients. Interestingly, a covenant which restricts the provision of medical services in a proscribed area is not, per se, void as against public policy.⁶⁸ Indiana courts have upheld as reasonable restrictive covenants which cover the entire area of a clinic's business, even

61. *Id.* The covenant at issue in *Smith* consisted of the following:

It is anticipated that Dave and the Company will enjoy a mutually advantageous and profitable relationship for many years, but should this relationship be terminated, Dave agrees that as a condition of employment as Vice President in charge of Sales and Marketing of the Company and in consideration of the Company's other covenants and agreements herein contained, that for a term equal to his length of employment as Vice President in charge of Sales and Marketing of the Company or in any other future capacity, but in no case less than one (1) year or more than three (3) years immediately after the termination of his employment with the Company he will not, directly or indirectly, compete with the Company *within the areas of his responsibilities* by performing services for any other concern which is in competition with the Company, whereby such competition in the opinion of the Company would be injurious to the Company. . . .

Id.

62. *Id.* at 113-15.

63. An example of a covenant which illustrates a case where geographic boundaries are not needed to create a valid restrictive covenant is found at *supra* note 52.

64. *E.g.*, *4408, Inc. v. Losure*, 373 N.E.2d 899 (Ind. Ct. App. 1978).

65. 373 N.E.2d 899 (Ind. App. 1978).

66. *Id.* at 902.

67. *Id.*

68. *E.g.*, *Raymundo v. Hammond Clinic Ass'n*, 449 N.E.2d 276, 279 (Ind. 1983).

though the doctor who is restricted treats patients who come from only part of the total area of the clinic's business.⁶⁹ This can be distinguished from the situations discussed above in which courts will generally only enforce a covenant as reasonable to the extent of an employee's work.⁷⁰ In each of five recent decisions involving covenants not to compete to which a doctor was a party, the covenant has been upheld as reasonable.

*Medical Specialists, Inc., v. Sleweon*⁷¹ is Indiana's leading case dealing with the reasonableness of geographic limitations in a covenant to which a doctor is a party. In *Sleweon*, Dr. Sleweon, an employee of Medical Specialists ("Specialists"), practiced infectious disease medicine. Specialists serviced patients from ten hospitals in the northwest part of Indiana.⁷² Sleweon signed a covenant not to compete with Specialists in which he agreed not to compete with Specialists within a ten-mile radius of the hospitals at which Specialists rendered patient services. Sleweon resigned and began working for hospitals that Specialist serviced, as well as hospitals that Specialists did not service, but which were within the geographic restriction contained in the covenant.⁷³ Despite the fact that the covenant prohibited competition in areas where the employer conducted no business, the court upheld all of the agreement's competitive restrictions.⁷⁴

In so holding, the *Sleweon* court relied upon *Fumo v. Medical Group of Michigan City*,⁷⁵ in which the court held that a covenant was not overbroad merely because it included hospitals in addition to those serviced by the employer.⁷⁶ The court in *Fumo* reasoned that when individuals travel to receive offered services, an employer may have a protectible interest extending over a geographical area greater than that previously serviced by the employee, particularly where the medical corporation has a "substantial patient base within the proscribed area."⁷⁷ Similarly, the *Sleweon* court found that patients traveled from Illinois in addition to Lake, Porter, LaPorte, Starke, St. Joseph, and Jasper Counties in Indiana.⁷⁸ Thus, the court held that the geographical restriction was reasonable even though it extended into Illinois and covered hospitals not served by Specialists.⁷⁹

69. See *Medical Specialists, Inc. v. Sleweon*, 652 N.E.2d 517 (Ind. Ct. App. 1995).

70. See *supra* notes 50-67 and accompanying text.

71. 652 N.E.2d 517 (Ind. Ct. App. 1995).

72. *Id.* at 520.

73. *Id.* at 521.

74. *Id.* at 528.

75. 590 N.E.2d 1103 (Ind. Ct. App. 1992).

76. *Id.* at 1109.

77. *Id.* (citing *Gomez v. Chua Med. Corp.*, 510 N.E.2d 191, 193 (Ind. Ct. App. 1987)).

78. *Medical Specialists, Inc. v. Sleweon*, 652 N.E.2d 517, 524 (Ind. Ct. App. 1995).

79. *Id.*

In finding the covenant's geographic scope reasonable, the *Sluweon* court noted that it normally would only consider whether a substantial patient base existed within the proscribed area.⁸⁰ Because the infectious disease practice was mainly dependent upon patient referrals from other doctors, however, as opposed to patient preference and selection,⁸¹ the court recognized that the employer's main business interest was to protect its referral source (the hospitals) from Dr. Sluweon's competition.⁸² Thus, the court held that Specialists did not have to prove that it had a "substantial patient base within the proscribed area" in order to have a reasonable geographic restriction.⁸³ The restrictive covenant, as drafted, was valid.

Despite the willingness of Indiana courts to broadly enforce restrictive covenants involving doctors, the court in *Fumo v. Medical Group of Michigan City*⁸⁴ noted that public policy problems are presented by such a practice.⁸⁵ The court stated that, "[w]here a specialist offers services uniquely or sparsely available in a specified geographical area, an injunction may be unwarranted because the movant is unable to meet the burden of showing that the public would not be disserved."⁸⁶ Although the *Sluweon* court downplayed this factor, finding that the area would not be underserved by prohibiting Sluweon from practicing, employers should recognize that courts are willing to examine this factor.

80. *Id.* (citing *Gomez v. Chua Med. Corp.*, 510 N.E.2d 191, 193 (Ind. Ct. App. 1987)).

81. *Id.*

82. *Id.*

83. *Id.*

84. 590 N.E.2d 1103 (Ind. Ct. App. 1992).

85. *Id.* at 1109.

86. *Id.* However, in *Hodnick v. Fidelity Trust Co.*, the court stated:

In the absence of a showing that any particular contract brought before the court is contrary to what the Constitution, the Legislature, or the judiciary have declared to be the public policy, it is necessary in order to have the court hold it void on the ground of public policy, to show clearly that such contract has a tendency to injure the public, or is against the public good, or is inconsistent with sound policy and good morals as to the consideration or as to the thing to be done or not to be done. Whether or not a contract is against public policy is a question of law for the court to determine from all of the circumstances in a particular case. The courts will keep in mind the principle that it is to the best interest of the public that persons should not be unnecessarily restricted in their freedom of contract and that their agreements are not to be held void as against public policy, unless they are clearly contrary to what the Constitution, the Legislature, or the judiciary have declared to be the public policy, or unless they clearly tend to the injury of the public in some way.

Hodnick v. Fidelity Trust Co., 183 N.E. 488, 491 (Ind. App. 1932).

E. Time Limitations

Like the geographic scope, the duration of a restrictive covenant must be reasonable in order to be enforceable. In fact, unlike covenants that lack specific geographic boundaries but may still be enforceable, a covenant *must* contain definite temporal limitations in order to be enforceable. An indefinite time restraint can render a covenant not to compete void and unenforceable.⁸⁷

The reasonableness of a time restraint is generally judged using three criteria. First, the length of the restraint must relate to the employer's protectible interest.⁸⁸ As with all other aspects of a restrictive covenant, if this requirement is not met, then the duration of the restraint is automatically unreasonable and no further inquiry into the next two criteria is necessary.⁸⁹ The case of *Captain and Co., Inc. v. Towne*⁹⁰ illustrates this issue. In *Towne*, the court found the covenant to be reasonable with the exception of the time restraint.⁹¹ The court concluded that a two-year time restraint on Towne, who estimated insurance clean-up work, was unreasonable because Towne possessed no confidential information, customer lists, or trade secrets.⁹²

Second, the restraint must not be so long in time as to injure the employee by precluding that person from pursuing his or her occupation as a means for support.⁹³ This could present a problem for the employer where the employee has specialized skills that do not translate well into another field and where the employer's market and, therefore area of interest, is national or global. In such a case, it may well be impossible to draft an enforceable covenant which fully protects all of the employer's interests. Such a covenant would, in effect, deprive the employee of the ability to earn a living for the specified time.

Finally, in order to be deemed reasonable, the restraint must not be so long in time as to interfere with the interests of the general public by depriving it of the restricted party's industry or services.⁹⁴ At what point the public itself has an interest that is paramount to that of the employer is unclear; however, the

87. *Harvest Ins. Agency v. Inter-Ocean Ins. Co.*, 492 N.E.2d 686, 690 (Ind. 1986).

88. *Frederick v. Professional Bldg. Maintenance Indus., Inc.*, 344 N.E.2d 299, 302 (Ind. Ct. App. 1976).

89. C.T. Drechsler, Annotation, *Enforceability of Restrictive Covenant, Ancillary to Employment Contract, as Affected by Duration of Restriction*, 41 A.L.R.2D 15, 34-35 (1955).

90. 404 N.E.2d 1159 (Ind. Ct. App. 1980).

91. *Id.*

92. *Id.* at 1162.

93. Drechsler, *supra* note 89, at 39-40.

94. *Id.* at 40.

physician cases discussed above⁹⁵ would provide fertile ground for such a public policy argument.

Once again, a court's evaluation of what will be deemed "reasonable" terms within a restrictive covenant must be made on a case-by-case basis. In making that determination, a court must balance the employer's right to protect its investment against the employee's right to earn a living. Indiana courts have upheld restrictions of one year,⁹⁶ eighteen months,⁹⁷ two years,⁹⁸ three years,⁹⁹ and five years¹⁰⁰ as reasonable.

F. Severability: The Blue Pencil Doctrine

The last, and perhaps most important, aspect in understanding covenants not to compete in Indiana is the "blue pencil doctrine." This judicial device emanates from the tradition of striking, or "penciling out," void, offensive or unreasonable language in a contract without rendering the entire agreement unenforceable. Thus, where a restrictive covenant contains both reasonable and unreasonable restrictions, the excessive or unreasonable portions may be disregarded or severed from the remainder, and the reasonable restrictions may be enforced by crossing out any overbroad clauses.¹⁰¹ This enables courts to give effect to the parties' intentions, if practicable.¹⁰² If, however, a covenant is deemed unreasonable and the court is not able to sever the unreasonable parts

95. See *supra* notes 68-86 and accompanying text.

96. *Licocci v. Cardinal Assoc.*, 445 N.E.2d 556, 562 (Ind. 1983); *Ackerman v. Kimball Int'l. Co.*, 634 N.E.2d 778, 786 (Ind. Ct. App. 1994); *Franke v. Honeywell, Inc.*, 516 N.E.2d 1090, 1094 (Ind. Ct. App. 1987).

97. *Mantek v. Share Corp.*, 780 F.2d 702, 711 (7th Cir. 1986)

98. *Barnes Group v. O'Brien*, 591 F. Supp. 454, 463 (N.D. Ind. 1984); *Field v. Alexander*, 503 N.E.2d 627, 636 (Ind. Ct. App. 1987).

99. *Leatherman v. Management Advisors, Inc.*, 448 N.E.2d 1048, 1050 (Ind. 1983); *Smart Corp. v. Grider*, 650 N.E.2d 80, 85 (Ind. Ct. App. 1995); *Hahn v. Drees, Perugini & Co.*, 581 N.E.2d 457, 460-61 (Ind. Ct. App. 1991); *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 217 (Ind. Ct. App. 1982); *4408, Inc. v. Losure*, 373 N.E.2d 899, 903 (Ind. Ct. App. 1978).

100. *Rollins v. American State Bank*, 487 N.E.2d 842, 843-44 (Ind. Ct. App. 1986); *Miller v. Frankfurt Bottle Gas*, 202 N.E.2d 395, 398 (Ind. Ct. App. 1964).

101. BLACK'S LAW DICTIONARY 173 (6th ed. 1990).

102. *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 215 (Ind. Ct. App. 1982). In *Seach*, an employee had covenanted not to compete with any present, past or prospective client of the employer. *Id.* at 209. The court concluded that the past and future restrictions were too broad and vague, but enforced the restrictions against the employer's present clients. *Id.* at 214. "Although the words 'present, past or prospective' client appear throughout the non-competition clause, we can enforce the acceptable portion of that phrase which applies to present clients of the Firm as they are a protectible interest." *Id.* at 215.

without rewriting the entire covenant, the blue pencil doctrine will not apply and the court will find that the entire restrictive covenant is unenforceable.¹⁰³

In *Smart Corp. v. Grider*,¹⁰⁴ Grider was employed by Smart Corporation as an Area Manager for the entire state of Indiana. Smart Corporation provided medical record copying services to hospitals and other health care providers.¹⁰⁵ Grider's responsibilities were limited solely to Indiana but the restrictive covenant that she signed required her not to compete with Smart anywhere in the United States for three years.¹⁰⁶ Two years later Grider was terminated by Smart. Soon after her termination, she began working for one of Smart's competitors, taking with her twenty of Smart's Indiana clients.¹⁰⁷ After concluding that the restrictive covenant was unreasonable as written, the court examined whether it could be "blue penciled."¹⁰⁸ The court held that the parties' intentions could be enforced by redacting the overbroad geographical limitation from the employment contract without adding any new terms or subjecting the parties to a contract lacking mutual consent, thereby giving effect to the parties' reasonable intent.¹⁰⁹

In *Licocci v. Cardinal Associates, Inc.*,¹¹⁰ the court examined a covenant composed of three parts: (1) Licocci was prohibited from soliciting sales from anyone in his former territories for sixty (60) days; (2) he was prohibited for sixty (60) days from calling upon, talking to, or soliciting any business from any customer of Cardinal Associates within or outside his former territories; and (3) he was prohibited from selling the same products to any of his former customers

103. *Licocci v. Cardinal Assoc.*, 445 N.E.2d 556, 561 (Ind. 1983). See also *Wiley v. Baumgardner*, 97 Ind. 66, 69 (1884).

104. 650 N.E.2d 80 (Ind. Ct. App. 1995). The covenant at issue in *Smart* read as follows:

The Employee hereby covenants and agrees that so long as she is either employed by the Company or for the term of this Agreement, and for the lessor of: (i) three (3) years after the Employee ceases to be employed by the Company or any affiliate or successor thereof; or (ii) so long as the Company or any affiliate or successor thereof carries on a like business to that presently conducted by the Company, the Employee will not, in any county or any state in the United States of America where the Company or any affiliate or successor thereof then carries on a like business to that presently conducted by the Company in the County of Los Angeles, California, to the extent permitted by applicable law, . . . [compete with Smart].

Id. at 84.

105. *Id.* at 82.

106. *Id.*

107. *Id.*

108. *Id.* at 84.

109. *Id.* The court surgically removed the following language from the restrictive covenant: "in any county of any state in the United States of America where the Company or any affiliate or successor thereof then carries on a like business to that presently conducted by the Company in the County of Los Angeles, California" *Id.*

110. 445 N.E.2d 556 (Ind. 1983).

for one year.¹¹¹ The court, applying the blue pencil doctrine, held that the third restriction was reasonable and could be enforced independently of the other two.¹¹²

Frederick v. Professional Building Maintenance Industries, Inc.,¹¹³ illustrates a rejection of the use of the blue pencil doctrine. In *Frederick*, the restrictive covenant involved eight Indiana, Michigan and Illinois counties: Lake, Porter, LaPorte and St. Joseph in Indiana; Berrien and Van Buren in Michigan; and Will and Cook in Illinois.¹¹⁴ The court in *Frederick* found the restraint to be overbroad and refused to give it validity by striking out those counties in which *Frederick* had had no activity.¹¹⁵ The court refused to find that each county was a severable and individual geographical limitation and, therefore, declined to enforce the covenant as drafted.

III. COVENANTS NOT TO COMPETE AND THE SALE OF A BUSINESS

A. *The History of Covenants Not to Compete Ancillary to a Sale of a Business Under Indiana Law*

Since 1884, Indiana courts have recognized the enforceability of covenants not to compete incidental to the sale of a business.¹¹⁶ Indiana courts have

111. *Id.* at 562. The covenant at issue in *Licocci* read as follows:

[T]he Representative does agree that for a period of sixty (60) days from and after the termination of this Contract the said Representative shall not engage in any business or activities, which directly or indirectly compete in anyway [sic] with the business and activities of the Corporation within the territory assigned to the Representative under this Contract; that the Representative will not for a period of Sixty (60) days from and after the termination of this Contract by either party as hereinafter setforth [sic] call upon, talk with or solicit any business from any customers of the Corporation within or outside the territory of the Representative as hereinafter setforth [sic]; and further that the Representative will not for a period of one year from and after the term of this contract by either party as herinafter [sic] set forth engage in, participate in, or in any way assist anyone else, directly or indirectly, selling to customers [sic] to whom said representative sold products during the time he was engaged as a Representative of Cardinal Associates Midwest, Inc. any product which is either identical to or essentially the same product as those products said Representative sold to that particular customer while he was representing Cardinal Associates Midwest, Inc.

Id. at 560-61.

112. *Id.* at 564.

113. 344 N.E.2d 299 (Ind. Ct. App. 1976).

114. *Id.* at 301.

115. *Id.* at 302.

116. *Buanno v. Wienraub*, 81 N.E.2d 600 (Ind. 1948); *Grand Union Tea Co. v. Walker*, 195 N.E. 277 (Ind. 1935); *Bennett v. Carmichael Produce Co.*, 115 N.E. 793 (Ind. 1916); *Eisel v. Hayes*, 40 N.E. 119 (Ind. 1895); *Consumers' Oil Co. v. Nunnemaker*, 41 N.E. 1048 (Ind. 1895); *Beatty v. Coble*, 41 N.E. 590 (Ind. 1895); *Wiley v. Baumgardner*, 97 Ind. 66 (1884); *R.P. Davis*,

established different criteria for reviewing and enforcing covenants ancillary to the sale of a business as opposed to those ancillary to employment contracts.

Courts are less likely to enforce restrictive covenants in employment contracts because an employee usually has little, if any, bargaining power.¹¹⁷ On the other hand, because of the presumed equality of bargaining power between a buyer and a seller of a business, and because the buyer is paying for the "goodwill" associated with the seller's business, which goodwill is often related to the seller personally, courts are more likely to enforce restrictive covenants incident to the sale of a business. In other words, a covenant ancillary to the sale of a business merely protects a buyer's investment,¹¹⁸ much of which may be in the business' goodwill.¹¹⁹ For that reason, although

Annotation, *Validity and Enforceability of Restrictive Covenants in Contracts of Employment*, 98 A.L.R. 963 (1935).

117. The reasons for this distinction are well stated in *Alexander & Alexander, Inc. v. Danahy*, 488 N.E.2d 22 (Mass. App. Ct. 1986), which is accepted by the Indiana courts. The court in *Alexander* reasoned as follows:

In the former situation [sale of a business] there is more likely to be equal bargaining power between the parties; the proceeds of the sale generally enable the seller to support himself temporarily without the immediate practical need to enter into competition with his former business; and a seller is usually paid a premium for agreeing not to compete with the buyer. Where the sale of the business includes good will, as this sale did, a broad noncompetition agreement may be necessary to assure that the buyer receives that which he purchased. . . . On the other hand, an ordinary employee typically has only his own labor or skills to sell and often is not in a position to bargain with his employer. Postemployment restraints in such cases must be scrutinized carefully to see that they go no further than necessary to protect an employer's legitimate interests, such as trade secrets or confidential customer information.

Id. at 28. See also C.T. Drechsler, Annotation, *Enforceability of Covenant Against Competition, Ancillary to Sale or Other Transfer of Business, Practice, or Property, as Affected by Territorial Extent of Restriction*, 46 A.L.R.2d 119 (1956); WILLISTON, *supra* note 18, at 122.

118. *McCart v. H & R Block, Inc.*, 470 N.E.2d 756, 763 (Ind. Ct. App. 1984).

119. "Good will," in this context, means "[t]he favor which the management of a business wins from the public. [It is] [t]he fixed and favorable consideration of customers arising from established and well-conducted business. . . . Good will is an intangible asset. [It is] [s]omething in business which gives reasonable expectancy of preference in [the] race of competition." BLACK'S LAW DICTIONARY 625 (5TH ED. 1979). Good will can also mean

[t]he custom or patronage of any established trade or business; the benefit or advantage of having established a business and secured its patronage by the public. . . . And as property incident to business sold, favor [which a] vendor has won from [the] public, and [the] probability that all customers will continue their patronage. It means every advantage, every positive advantage, that has been acquired by a proprietor in carrying on his business, whether connected with the premises in which the business is conducted, or with the name under which it is managed, or with any other matter carrying with it the benefit of the business.

Id. Good will is "[t]he ability of a business to generate income in excess of a normal rate on assets due to superior managerial skills, market position, new product technology, etc. In the purchase of a business, good will represents the difference between the purchase price and the value of the

the same test of reasonableness is used to judge covenants ancillary to the sale of a business, it is applied in a somewhat less stringent manner. Thus, a restriction might be reasonable as applied to the seller of a business, but may be found unreasonable as applied to a former employee.

B. A Buyer's Protectible Interest

The primary difference between enforcement of a restrictive covenant ancillary to the sale of a business and one ancillary to an employment contract is the manner in which the court analyzes the "protectible interest." The first step in analyzing a covenant not to compete ancillary to the sale of a business is to determine whether a protectible interest has been purchased.¹²⁰ In many cases, the parties, by the terms of their purchase agreement, will specifically provide that there is a protectible interest in the goodwill of the seller's business.¹²¹ Even if the parties do not agree, if the buyer purchases the goodwill associated with the seller's business, the court will find a protectible interest. Accordingly, a protectible interest in the sale of a business is much easier to show than a protectible interest in an employment contract.

C. Geographic Limitations

Indiana courts are also more indulgent regarding the reasonableness of geographic limitations in restrictive covenants ancillary to the sale of a business.¹²² Nevertheless, of all the elements of reasonableness, courts have most closely examined the element of geographic limitations.¹²³ Like covenants ancillary to employment contracts, the geographic limitations must not be broader than necessary to protect the buyer's interest.

*Fogle v. Shah*¹²⁴ is the leading Indiana case analyzing restrictive covenants incident to the sale of a business. In *Fogle*, Shah wanted to buy

net assets." *Id.* The court, in *Mohawk Maintenance Co. v. Kessler*, defined the goodwill of a business as an intangible asset which may be transferred from seller to purchaser, and it becomes the buyer's right to expect the firm's established customers will continue to patronize the purchased business. *Mohawk Maintenance Co. v. Kessler*, 419 N.E.2d 324, 329 (N.Y. 1981).

120. *Pickett v. Pelican Serv. Assocs.*, 481 N.E.2d 1113, 1118 (Ind. Ct. App. 1985).

121. *See supra* notes 119-20.

122. *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 212-13 (Ind. Ct. App. 1982). *See also* Robert A. Brazener, Annotation, *Validity and Construction of Restrictive Covenant not to Compete Ancillary to Franchise Agreement*, 50 A.L.R.3d 746, 749 (1973).

123. *Ridgefield Park Transp. v. Uhl*, 803 F. Supp. 1467, 1470 (S.D. Ind. 1992). In *Uhl*, the court found a restrictive covenant ancillary to the sale of a business overbroad and unreasonable because it restricted the entire United States when the seller only occasionally hauled freights across the United States; the seller's business mainly consisted of serving a few major clients over established routes. *Id.* at 1470.

124. 539 N.E.2d 500 (Ind. Ct. App. 1989).

Fogle and Associates ("F & A"), a pension consulting firm, from the Fogle. Shah agreed to pay the Fogle a total of \$1,000,000 for F & A, with \$850,000 paid for the company and \$150,000 paid for the covenants not to compete.¹²⁵ The restrictive covenants signed by the Fogle contained a three-year time restraint covering twelve states.¹²⁶ About one year after the sale, the Fogle formed a competing pension consulting business and started contacting F&A's former clients.¹²⁷ The *Fogle* court examined three factors to determine whether a restrictive covenant ancillary to the sale of a business is overbroad as to time, space, or the activity restricted:¹²⁸ "(a) whether the covenant is broader than necessary for the protection of the covenantee . . . [buyer] in some legitimate interest, (b) the effect of the covenant upon the covenantor . . . [seller], and (c) the effect of the covenant upon the public interest."¹²⁹

There are four factors to be considered in determining whether the covenant is necessary for the protection of the buyer: (1) the type of business sold, (2) the inclusion of territory into which the transferring business did not extend, (3) the extent of the purchaser's original business, and (4) the period of restraint.¹³⁰ Of these, perhaps the most important is the nature of the business being bought and sold. There are essentially three classifications into which most businesses fall: (1) service businesses, (2) those engaged in the distribution of goods, and (3) those engaged in the production, manufacturing, or processing of goods.¹³¹

125. *Id.* at 501.

126. *Id.* The covenant read as follows:

(a) For a period of three (3) years from the date of closing, neither Seller [John Fogle] nor [Karen] Fogle shall, directly or indirectly, engage in any activities within the States of Indiana, Michigan, Ohio, Illinois, Kentucky, Missouri, Louisiana, Oklahoma, Wisconsin, Tennessee, Pennsylvania or West Virginia either as an owner, shareholder, director, officer, employee or in any other capacity, on behalf of himself or herself or any third party, which are competitive with respect to the services provided by the Seller prior to closing.

(b) Neither Seller nor Fogle shall at any time, or in any manner, directly or indirectly, solicit or accept any business which is competitive with respect to the services provided by Company [F & A] prior to closing from any person, firm, corporation or other entity which is a client of Company at the time of the closing or which had been such a client of Company at any time within the period of six (6) months prior to the date of the closing; nor shall Seller nor Fogle in any way, directly or indirectly, request or advise any client or the Buyer to withdraw any business with Buyer.

Id.

127. *Id.*

128. *Id.* at 503.

129. *Id.*

130. Drechsler, *supra* note 117, at 228-60. Note that the *Fogle* court adopted these factors in its decision. *Fogle v. Shah*, 539 N.E.2d 500, 503 (Ind. Ct. App. 1989).

131. Drechsler, *supra* note 117, at 228-30. These factors were also accepted by the court in *Fogle*. See *Fogle*, 539 N.E.2d at 503-04.

In *Fogle*, F & A was clearly a service business. Ordinarily, a geographic limitation in a restrictive covenant ancillary to the sale of a service-oriented business should be localized because services are normally performed within a small geographic area.¹³² However, the *Fogle* court found that the territory covered in the restrictive covenant reasonably extended into many states because of the nature of the pension consulting business involved. The court did not specify why the nature of a pension consulting business allowed for such an expansion.

A second element in determining whether the geographic limitation is reasonable concerns the effect upon the buyer of including territory into which the transferring business did not extend at the time of the sale.¹³³ The issue before the court in *Fogle* was whether it was unreasonable to prevent the Fogles from competing in twelve states completely when in nine of the states F & A only had four clients, and in one state, Louisiana, F & W had no clients. The court found that a buyer who purchases a business with the intention of extending its scope is entitled to bargain with the sellers to prohibit them from competing within the territory into which the buyer plans to expand.¹³⁴ Such an agreement is not against public policy where the area of the geographical limitation is no greater than that which the parties foresee the expanded business will cover.¹³⁵ The court found that Shah intended to expand F & A's business throughout the entire territory covered in the covenant and that the Fogles were aware of this fact.¹³⁶

With regard to the third factor, the extent of the purchaser's original business, the court found that this also evidenced the reasonableness of the territorial limitation in question.¹³⁷ Prior to Shah purchasing F & A, Shah owned a pension consulting firm that had 128 clients of its own. When Shah hired the Fogles to work for him, the Fogles acquired contacts with many, if not all, of Shah's original clients. The court concluded that Shah had a protectible interest in those clients (i.e. in his original business) in addition to the goodwill acquired when he purchased F & A.¹³⁸

In reviewing the effect of the covenant upon the sellers, the court found that where the sale of a business is concerned, the effect of the covenant on the seller is legally insignificant because the seller has willfully and freely entered into the

132. Dreschler, *supra* note 117, at 230.

133. *Fogle*, 539 N.E.2d at 504.

134. *Id.*

135. *Id.*

136. *Fogle v. Shah*, 539 N.E.2d 500, 505 (Ind. Ct. App. 1989).

137. *Id.*

138. *Id.*

covenant and accepted a significant amount of consideration for doing so.¹³⁹ Finally, the court examined the effect of the covenant on the public interest. The court found that any restraint on trade would be slight because pension consulting firms were common and the loss of one would not tend to restrain trade or injure the public.¹⁴⁰

D. Time Limitations

The final factor a court must find to be reasonable in a restrictive covenant incident to the sale of a business is the time limitation. In *Fogle, Shah* paid a significant amount of money for the restrictive covenants and even hired the Fogles as employees to work for him. Thus, the court found that the three year time limitation contained in the restrictive covenant was reasonable in itself.¹⁴¹ Other Indiana courts have upheld time limitations in restrictive covenants ancillary to the sale of a business. Some of these have been as high as five years.¹⁴² In general, Indiana courts have not experienced difficulty with time limitations in restrictive covenants incident to the sale of a business.

E. Severability: The Blue Pencil Doctrine

The blue pencil doctrine is applied in the same manner for a restrictive covenant ancillary to the sale of a business as it is with a restrictive covenant ancillary to an employment contract. For the blue pencil doctrine to apply, the covenant must be clearly separated into parts with some parts being reasonable and other parts being unreasonable. Although applied in the same manner, there are no examples of Indiana courts using the blue pencil doctrine in a restrictive covenant ancillary to the sale of a business.

IV. DRAFTING TECHNIQUES AND ISSUES

As seen by the above discussion, covenants not to compete are, even when deftly drafted, sometimes difficult to enforce. Before a good, that is to say enforceable, covenant not to compete can be drafted, the drafter must have a

139. *Id.*

140. *Id.* at 505-06.

141. *Id.* at 500 (citing *Pickett v. Pelican Serv. Assoc.*, 481 N.E.2d 1113, 1119 (Ind. Ct. App. 1985)). The court in *Pickett* held that a five year restrictive covenant was reasonable because of the personal nature of the business, the need to protect the clients, and the significant consideration given for the covenants not to compete including hiring the Picketts as employees. *Pickett*, 481 N.E.2d at 1118-19.

142. *South Bend Consumers Club, Inc. v. United Consumers Club, Inc.*, 572 F. Supp. 209 (N.D. Ind. 1983) (finding the two year restraint reasonable, but holding that the geographic limitation was overbroad and therefore unenforceable); *McCart v. H & R Block, Inc.*, 470 N.E.2d 756 (Ind. Ct. App. 1984).

clear idea of what he or she is hoping to accomplish with the covenant. Is the client concerned with retention of employees, protection of information, retention of clients or some combination of all three? Before an effective covenant can be drafted, it is important that the draftsman have detailed knowledge regarding the nature of the employer's business, the type of employees who will be executing the covenant, and the goals which the client wishes to accomplish via use of the covenant. The more knowledge the draftsman is armed with, the more narrowly he or she will be able to draft the covenant and the higher the likelihood that courts will deem the covenant enforceable.

Where the goal is employee retention, "a non-piracy provision can reduce the 'pied piper' phenomenon, in which one highly respected employee defects to a competitor, and her underlings follow suit. Moreover, it lessens the chance that a competitor will raid an entire unit or office."¹⁴³ Similarly, tying deferred compensation to violations of the covenant, and/or drafting so called "golden handcuff" agreements, in which large sums of money are deferred to a date in the future, can be effective mechanisms for retaining key employees.

Where the goal is customer retention, the draftsman must be as precise as possible both in terms of the activity that will be restricted as well as with regard to geographic and temporal limitations. Perhaps most important, the employer should strive to be as reasonable as possible. If the employer can satisfy its competitive concerns by a one year restriction, it should not seek a two year restriction. Similarly, where the employer can be protected by using a narrower geographic scope, it should be used. This makes it difficult to use a "generic" covenant not to compete for different types or levels of employees. For example, a salesperson probably will require a completely different kind of covenant than will a senior management official.

In any case, even the most careful draftsman of a covenant not to compete may, when it comes time to enforce the covenant, face difficulties. These difficulties may arise from the employer's inability to establish appropriate facts to support the breadth of the covenant with regard to a particular employee, the fact that there has been a change in job duties subsequent to the time the covenant was executed thus creating an imperfect fit, or due to a change in the market or in the business of the employer. For these reasons, the careful draftsman will take into consideration Indiana's adherence to the blue pencil doctrine and draft the covenant so that each of its restrictive provisions is severable from the others. This will enable a court to strike out those provisions

143. David Lawrence Hankey, *A Corporate Counsel's Primer on Restrictive Covenants*, PRAC. LAW., Jan. 1993, at 31, 31-34.

it deems unreasonable at the time the covenant is sought to be enforced while leaving intact those provisions deemed reasonable. Where a covenant is drafted as a unified whole, blue penciling is impossible and will not be undertaken by the court. In fact, it may be helpful to include, as one of the paragraphs of the covenant, a section stating that the parties agree that each sentence, term, or provision of the agreement shall be considered severable and that should one portion of the agreement be deemed unreasonable, the other provisions of the agreement will not be affected thereby.

V. CONCLUSION

Despite their fact sensitivity, restrictive covenants are enforceable in Indiana. There are, however, certain well defined requirements that must be present in order to have a valid restrictive covenant: the restrictive covenant must be reasonable; there must be a valid employer protectible interest; the geographic limitation must be reasonably necessary to protect the employer's interest; and the time restraint must be (1) related to the employer's protectible interest, (2) not be so long in time as to injure the employee by precluding that person from pursuing his or her occupation as a means for support, and (3) not interfere with the general public by depriving it of the restricted party's industry or services. It is, of course, the application of these requirements to the particular facts facing an employer or an employee that can be exceedingly difficult. The concept of "reasonableness" can vary depending upon the employer, the industry, and the employee. Nevertheless, employers can take some comfort in the application of the blue pencil doctrine by Indiana courts. By "layering" the restrictions, an employer may be able to assure itself, in advance, that Indiana Courts will find some portion of its covenant enforceable.