Santa Clara Law Review

Volume 4 | Number 1

Article 9

1-1-1963

Noncompetition Covenants: An Unexpected Interpretation Notes and

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NONCOMPETITION COVENANTS: AN UNEXPECTED INTERPRETATION

The businessman who has sold his business and incidentally agreed not to compete with the new owner might think that his troubles are finally over. But in the light of a recent district court of appeal decision, his troubles might be just starting. *Harrison v. Cook*[1] decided that a seller breached his covenant not to "establish or conduct" a competing business when he loaned money to his son, who then established a competing business. A businessman would probably be surprised to discover that he gave up his unrestricted right to loan money when he signed a standard noncompetition covenant.

The court considered the *Harrison* case one of first impression in California. Though many other jurisdictions have decided cases with similar factual situations, the court disregarded the principles which they developed. Instead it based its decision on a fundamental principle of contract law which apparently has never been applied in a similar situation. The result was unexpected and exposes standard noncompetition covenants to uncertain interpretation.

This article will examine the novel rationale of the *Harrison* decision. We will first survey California law, then cases from foreign jurisdictions. Finally the unique premise on which the *Harrison* decision is based, and its possible effect on the drafting of noncompetition covenants, will be analyzed.

HARRISON V. COOK: COVENANT BREACHED BY LOAN

For thirty-six years Homer Cook was associated with Cook-Nichols Company, an electrical wholesale supply business in Pasadena. In September of 1957 he sold all the stock in his business to six buyers who paid $40,000 down and gave Cook five installment notes for $75,000. Included in the contract of sale was this provision:

> 16. Agreement not to Compete. Cook agrees . . . that he shall not establish or conduct or lend his name to any business organization doing business in [5 counties] which is competing or attempting to compete with any line of business now engaged in by the Company.[2]

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[1] 213 A.C.A. 557, 29 Cal. Rptr. 269 (1963). Hearing denied by the California Supreme Court, April 24, 1963.

[2] *Id.* at 558, 29 Cal. Rptr. at 270.

Cook's son, who had been employed in the business since 1949, remained with the new owners for three months. He then asked Cook for a loan so that he could open a new business in competition with Cook-Nichols. In January 1958 Cook loaned his son $20,000 to provide two-thirds of the capital needed to open the new business, located just two blocks from Cook-Nichols. Later Cook guaranteed the important Anaconda account for his son's company.

Within a short time the son induced three of Cook-Nichols' key employees to come to work for him. Soon the new business was selling almost entirely to former customers of Cook-Nichols. As its sales soared, Cook-Nichols' business fell off drastically. By July 1959 Cook-Nichols was forced to make an assignment for the benefit of creditors and close its doors.

The buyers, faced with making payments on their notes, brought an action for a declaratory judgment defining the rights and liabilities of the parties. They obtained a preliminary injunction against assignment by Cook of the notes. Cook filed a cross-complaint in which he sought to recover on the promissory notes.

The trial court found that the competition provided by the new business, made possible by Cook's loan, his guaranteeing of one account, and the defection of Cook-Nichols' key employees were the primary causes of the company's failure. It granted an injunction restraining Cook from negotiating, assigning, transferring, selling, or declaring in default or attempting to collect the notes.

On appeal the district court of appeal stated that, if he breached his covenant not to compete, Cook forfeited his right to recover on the notes. A party who complains of breach of contract cannot recover unless he has fulfilled his obligations.[3] But did Cook violate his promise not to compete? The court conceded that "technically, defendant is correct in insisting that he neither 'established' nor 'conducted' any business organization which was competing with any line of business of Cook-Nichols Company, nor in any literal sense did he 'loan his name' to a competitive business."[4] But the court added that the agreement is not to be "narrowly, technically" construed.[5]

Quoting from cases, the court set out two principles: (1) When the good will of a business is sold, it is not patronage of the gen-

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[3] Pry Corp. of America, 177 Cal. App. 2d 632, 639, 2 Cal. Rptr. 425, 429 (1960).
[4] 213 A.C.A. at 560, 29 Cal. Rptr. at 271.
[5] *Ibid.*

eral public that is sold, but that particular patronage which has become an asset of the business;[6] (2) the law implies in every contract a covenant that neither party will do anything to deprive the other of the benefits of the contract.[7] Finding no California case precisely in point, the court cited *Dowd v. Bryce*[8] as one that "gives effect to this philosophy of statements that we have just quoted" and determines the conclusion in this case.

In the *Dowd* case the seller of a grocery-liquor store promised not to compete or to sell land to any one contemplating a business which would compete with the buyer. In an action for declaratory judgment the court held that the seller would breach his covenant if he leased property to one who planned to compete. Without further discussion of the *Dowd* case or the "philosophy" it was said to encompass, the court concluded that Cook breached his noncompetition agreement and thus could not recover any of the payments due under the $75,000 notes.

COVENANTS NOT TO COMPETE: CALIFORNIA CASES

California's Business and Professions Code Section 16600 voids every contract to the extent that it restrains anyone from engaging in a lawful profession, trade, or business. Two exceptions provide for certain types of noncompetition agreements, which are restraint on trade and business. Business and Professions Code Section 16601 allows the seller of the good will of a business, or any shareholder selling all his shares in a corporation,[9] to agree not to carry on a competing business within a specified geographical area where the business has been operating. Business and Professions Code Section 16602 permits similar noncompetition agreement in partnership dissolutions.[10]

Since a California contract for the sale of a business may include a noncompetition covenant,[11] the courts occasionally are called upon to determine what is a breach of a covenant not to

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6 Bergum v. Weber, 136 Cal. App. 2d 389, 392, 288 P.2d 623, 625 (1955).

7 Brown v. Superior Court, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949); Harm v. Frasher, 181 Cal. App. 2d 405, 417, 5 Cal. Rptr. 367, 374 (1960); Bergum v. Weber, 136 Cal. App. 2d 389, 392, 288 P.2d 623, 625 (1955). Only the last case deals with a non-competition covenant.

8 95 Cal. App. 2d 644, 213 P.2d 500, 14 A.L.R.2d 1329 (1950).

9 64 CORBIN, CONTRACTS § 1388 (1962). After *Harrison* was decided, Business and Professions Code § 16601 was amended (Cal. Stats. 1963, ch. 597, § 1, p. 785) to include shareholders of a corporation selling substantially all its assets.

10 See generally Comment, 1 SANTA CLARA LAW. 28 (1961).

11 CONTINUING EDUCATION OF THE BAR, THE STATE BAR OF CALIFORNIA, ADVISING CALIFORNIA BUSINESS ENTERPRISES 1002 (1958).

compete. In some cases the seller[12] has been so straightforward in his competitive activity that the court has no difficulty finding a breach. In *Akers v. Rappe*[13] a seller who had entered into a noncompetition agreement furnished his son with a building and finances so that he could compete with the buyer. He advised his son, did all of the difficult jewelry repair work, and made sales and collections. To emphasize to the public his connection with his son's business he did his work at a bench in the front window of the shop. This, held the court, was a flagrant violation of the spirit and letter of the contract.

A seller who bought part interest in a competing business and managed it violated his agreement. Even if the seller had acquired no pecuniary interest in the business, commented the court in *Johnston v. Blanchard*,[14] he would have breached his covenant by acting as its manager. Bringing one's skill, name, and influence to the aid of a competitor violates a noncompetition covenant.

Seller convenanted not to buy into a competing orchard heater business or manufacture orchard heaters. He then associated with a manufacturer and marketer of competitive products and added his well-known name to the competitor's business. The court in *Mahlstedt v. Fugit*[15] enjoined the seller from breaching his covenant by associating with a competitor.

In these cases the seller made no attempt to disguise his competitive activity. His violation of the covenant not to compete was direct and even flagrant. In other cases the seller has been more ingenious and has attempted to circumvent his agreement. Perhaps the earliest attempt to disguise competition is found in *Meyers v. Merillion*.[16] There a seller argued that he had not breached his covenant by merely acting as agent for a competitor. He asserted that a noncompetition covenant could be construed to restrain him only from carrying on a competing business, not acting as its agent. The court saw through the sham and held that an agent of a competitor does carry on the competitor's business.

A seller may try to find a method of getting somebody else,

12 The following "abbreviations" are used in this article: seller = seller of a business and its good will who has covenanted not to compete; buyer = buyer of such business; competitor or competing business = person or business who competes with the buyer; covenant, agreement, or promise = standard covenant not to establish or carry on a competing business within a certain geographical area, often limited to a certain period of time.

13 30 Cal. App. 290, 158 Pac. 129 (1916).

14 16 Cal. App. 321, 116 Pac. 973 (1911).

15 79 Cal. App. 2d 562, 180 P.2d 777 (1947).

16 118 Cal. 352, 50 Pac. 662 (1897).

who is not bound by an agreement, to compete in his behalf. A seller bought a competing business and leased it to another. He loaned money to the lessee to construct buildings and became an employee of the business. In *H. G. Fenton Mat. Co. v. Challet*[17] the court enjoined the seller from aiding the lessee, and lessee from aiding the seller, in violating the noncompetition agreement. Commented the court: "The court may . . . enjoin the party complained of not only from violating [the covenant's] terms but also employing or combining with others to accomplish the same result."[18]

Attempting to get around his obligation not to compete, another seller formed corporations which competed with the buyer's business. In *Bramwell v. Airport Blue Print Co.*[19] the court affirmed a judgment for an injunction and damages, holding that the corporations were "formed for the purpose of enabling [the seller] to circumvent his convenant with the plaintiff, and that [the seller] dominates and controls the said corporations." Similarly where a seller's wife bought stock in a competing corporation, using seller's money, the court held that the seller seriously breached his agreement.[20]

The California cases indicate that a seller breaches his noncompetition covenant whenever he competes with the buyer, whether he does this directly or obliquely. Attempts to disguise competition by setting up a front or working through third parties have failed. But until the *Harrison* case, no California case had decided whether a seller's loan to a competitor fell within the class of activities prohibited. Other jurisdictions, though, have been called upon to decide whether a loan to a competitor violated a noncompetition agreement.

LOANS TO COMPETITORS: FOREIGN JURISDICTIONS

A. *Loan or Credit Only*

Courts have long held that a seller who loans money to finance a competitor's business does not violate his covenant. In *Bird v. Lake*[21] the court held that the seller of a restaurant did not violate his covenant by financing a competing restaurant, even though his only security for repayment was the competitor's profits. The

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17 49 Cal. App. 2d 410, 121 P.2d 788 (1942).
18 *Id.* at 415, 121 P.2d at 791.
19 154 Cal. App. 2d 57, 315 P.2d 360 (1957).
20 Macken v. Martinez, 214 A.C.A. 840, 29 Cal. Rptr. 867 (1963).
21 1 Hem. & M. 338, 71 Eng. Rep. 147 (V.C. Court 1863).

seller would have breached his agreement, though, if he had acted as manager of a competitor's restaurant, or even as a waiter. Nothing, added the court, would prevent the seller from buying restaurants and reselling them.

In *Harkinson's Appeal*[22] a benevolent seller set her son up in business by advancing money and otherwise helping him. Citing *Bird v. Lake* the court stated that a covenant is not violated when a seller loans money to a competing business, or takes back a mortgage to secure a loan, even though the competitor's only means of repayment is out of the competing business' profits.

Though a seller who loans money to a competitor may not act in "perfect good faith," commented the court in *Finch Bros. v. Michael*,[23] he does not violate his covenant.

Selling a business or goods to a competitor on credit does not violate a seller's covenant not to compete. In *William Cory & Son Ltd. v. Harrison*[24] a seller sold one of his businesses and covenanted not to be "engaged or concerned or interested in" competing businesses. Later he sold an allied business on credit to one who began competing with the first buyer. The court held that though in the ordinary sense the seller was "concerned or interested in" the competing business, in the businessman's understanding he was not. It would be impracticable to hold a seller liable simply because he became a creditor of a competitor. Another court held selling stock to a competing druggist and taking a mortgage for the price did not violate the seller's noncompetition agreement.[25]

A recent Massachusetts case[26] closely parallels the *Harrison* fact situation. The owner of a wholesale candy and tobacco business sold out and agreed he would not "directly or indirectly, as employer or otherwise, engage in the wholesale candy or tobacco business in . . . Massachusetts in a capacity were [seller] will personally solicit, directly or indirectly, retailers . . . nor do anything to the prejudicing of the good will." Seller later became comaker of a $20,000 note for a loan to his son-in-law, who used the money to start a competing business. The seller took the accounts receivable of the competing business as security. He did nothing else to help the business.

The court decided that the purpose of the covenant was to exclude the seller from activity which would interfere with his for-

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22 78 Pa. 196, 21 Am. Rep. 9 (1875).
23 167 N.C. 322, 83 S.E. 458 (1914).
24 [1906] A.C. 274.
25 Reeves v. Sprague, 114 N.C. 647, 19 S.E. 707 (1894).
26 Slate Co. v. Bikash, 343 Mass. 172, 177 N.E.2d 780 (1961).

mer business' existing customer relationships and might be especially effective because of his relation with his old customers. But the seller's loan to a competitor in no way attracted old customers to the son-in-law's business. The seller made no use of his personal relationships or experience to gain his former customers for the new business. At most he helped a competitor finance his business, without any publicity or attempt to attract old customers. The court refused to interpret the seller's covenant to include a restraint on loaning money to a competitor, even though the seller had expressly agreed not to do "anything to the prejudicing of the good will."

The principle is clear. A seller does not breach his agreement to refrain from competing by loaning money to a competitor, whether he extends credit on the sale of a business or goods or otherwise finances him. But the courts have gone further. Even the seller who actively helps a competitor, in addition to loaning him money or otherwise financing him, is often held not to have violated his agreement.

B. *Loan Plus Other Help*

The case of *General Bronze Corp. v. Schmeling*[27] presents an unusual situation which exemplifies the courts' tendency to allow a loan to a competitor plus other direct aid. Sellers agreed not to engage in a competing business, though they reserved the right to become employees of a competitor. When the sellers violated their covenant by acquiring a competing business, the buyer obtained an injunction ordering the sellers to dissolve the offending business. In compliance the sellers sold the firm's assets to another competitor and became the latter's employees, each seller to have salary plus a share of the competitor's profits. Though the sellers had reserved the right to become employees of a competitor, it was argued that the total transaction constituted at least indirect competition. But the court held that the transaction did not constitute a forbidden investment. The sale created only a creditor-debtor relationship between the sellers and the competing business, which was not a breach of sellers' promise.

Other cases have reached the same result.[28] In *Adams v. Adams*[29] a seller, while not loaning money to a competitor, helped his wife and another establish and conduct a competitive business.

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[27] 213 Wis. 150, 250 N.W. 412 (1933).

[28] Battershell v. Bauer, 91 Ill. App. 181 (1900); McKeighan Wachter Co. v. Swanson, 138 Wash. 682, 245 Pac. 10 (1926).

[29] 156 Neb. 778, 58 N.W.2d 172 (1953).

Seller had no financial interest in the business. The court held that a covenant in restraint of trade is strictly construed in favor of the party on whom the restraint is imposed. "If he [seller] had furnished financial assistance to his wife that would not have constituted setting up and establishing a new competitive business. . . ."[30] The seller bound himself only to refrain from establishing a competing business. Thus he could with impunity help his wife in her competing business.[31]

Not all courts are so generous to the seller who reaches the borderline of competition. Some cases hold that a seller who not only loans money but also extends other aid to a competitor has pushed beyond the twilight zone into the area of active competition forbidden him. In *C. H. Barret Co. v. Ainsworth*[32] a seller advanced his son $1500 to start a competing grain elevator and endorsed a note for the business. In addition he gave freely of his advice and evidently bought grain for his son. The court found that the seller violated his agreement.

After agreeing not to become interested in a competing business, a seller helped his brother-in-law establish a business next door to the buyer. He extended credit, guaranteed accounts, advised on choices of merchandise, and went with his brother-in-law to make selections. The seller's influence was too evident in the conduct of the competitive business, and the New York court found that the seller breached his covenant.[33]

Where a seller financed a competitive business established by his wife and also managed it the court held that this was nothing more than an evasion of his agreement.[34]

Only one case has been found that holds, as does *Harrison,* that a seller who loans money to a competitor breaches his noncompetition convenant. In *Davis v. Barney*[35] a seller transferred his half-interest in a line of stages and promised that he would "not be concerned, directly or indirectly, in any line of stages in opposition to them." The court held that this agreement would be violated if the seller furnished a competing line with money, credit, or other assistance. It is not clear whether the seller merely made loans to the competitor or also gave him other help.

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30 *Id.* at 789, 58 N.W.2d at 179.
31 See also Smith v. Hancock, [1894] 2 Ch. 377 (C.A.).
32 156 Mich. 351, 120 N.W. 797 (1909).
33 Amsterdam v. Marmor, 125 Misc. 865, 212 N.Y.S. 300 (Sup. Ct. 1925).
34 Weickgenant v. Eccles, 173 Mich. 695, 140 N.W. 513 (1913).
35 2 Gill. & J. 382 (Md. Ct. App. 1830).

DEPARTURE FROM RULE: A NEW PRINCIPLE?

A. *Bergum v. Weber*: *Implied Covenant of Good Faith*

What influenced the court to depart from this long and established line of authority? To begin with, no California case found by the court dealt with precisely the situation presented in *Harrison*. Thus the rule that a seller does not violate his covenant when he loans money to a competitor, generally accepted elsewhere, had never been applied in California. Though the court apparently did not consider itself bound by this rule, it did not explain its reasons for disregarding it. Instead the court turned to another principle of law as a rationale for its decision.

The principle of contract law on which the court based its conclusion is an elementary one: in every contract is implied a covenant of good faith, that neither party will do anything to deprive the other of the benefits of the contract.[36] While three cases are cited by the court in support of this proposition, only one deals with breach of a noncompetition agreement.[37]

In *Bergum v. Weber*[38] seller sold his share of a partnership to his partner and expressly agreed that he would not directly or indirectly engage in a competing business for a period of one year. After the expiration of one year seller began to solicit actively customers who had continued doing business with his former partner. The seller did not thereby breach his express covenant which had expired. But, asks the court, did the seller violate an implied covenant? "The law implies in every contract a covenant that neither party will do anything that will deprive the other of the fruits of his bargain."[39] A seller's direct solicitation of old customers is a violation of this covenant.[40] Though the seller may begin soliciting the patronage of the general public after his general noncompetition covenant expires, he violates this implied covenant of good faith if he directly solicits the business of his old customers.

The seller raised an interesting point in his defense. He contended that where parties to a contract expressly agree as to any

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36 1 WITKIN, SUMMARY OF CALIFORNIA LAW 271-273 (7th ed. 1960).

37 Bergum v. Weber, 136 Cal. App. 2d 389, 288 P.2d 623 (1955). Cases not dealing with noncompetition covenant: Brown v. Superior Court, 34 Cal. 2d 559, 212 P.2d 878 (1949) deals with a contract to make mutual wills; Harm. v. Frasher, 181 Cal. App. 2d 405, 5 Cal. Rptr. 367 (1960) concerns a contract for sale of corporate stock.

38 136 Cal. App. 2d 389, 288 P.2d 623 (1955).

39 Bergum v. Weber, *supra* note 38, at 392, 288 P.2d at 625. The same sentence is quoted in *Harrison* at 560, 29 Cal. Rptr. at 271.

40 Handyspot Co. v. Buegeleisen, 128 Cal. App. 2d 191, 274 P.2d 938 (1954).

matter, no covenant as to that matter may be implied.[41] Since he expressly agreed not to compete for one year, this should be the literal limit of his obligation. A further covenant, since it deals with the subject matter expressly agreed upon, could not be implied.

The court conceded that it could not imply an obligation on the seller's part if the parties expressly contracted as to that obligation. Neither could a promise by the seller be implied if it would be inconsistent with an express obligation. But, though the express restrictive covenant and the implied covenant of good faith dealt with related subject matter, the implied promise was not contradicted by or inconsistent with the express promise.[42] Since the express covenant did not indicate any intention that the usual covenant of good faith should not be implied, the court found that the two covenants were consistent and could exist side by side.[43]

Bergum v. Weber thus stands for two propositions: (1) Every contract contains an implied covenant by each party not to deprive the other of the benefit of the contract. This covenant of good faith is violated by a seller who directly solicits business from his former customers. (2) This covenant not to solicit former customers directly may be implied even though the parties have contracted on the subject of noncompetition, so long as the covenants are not contradictory or inconsistent.

That the seller of a business in a sale which includes good will is not permitted to solicit his old customers directly even in the absence of a noncompetition covenant, is clearly correct.[44] Unless he had agreed otherwise, he may solicit customers from any other source.[45] If he agrees not to compete, though, and the covenant expires, the court is not rewriting the contract when it holds the seller obligated to refrain from direct solicitation of former customers. The buyer gave consideration for the right to be free from that specific type of interference when he purchased the seller's good will.[46]

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[41] CAL. CIV. CODE § 1656: "All things that in law or usage are considered as incidental to a contract, or as necessary to carry it into effect, are implied therefrom, unless some of them are expressly mentioned therein, when all other things of the same class are deemed to be excluded."

[42] 3 CORBIN, CONTRACTS § 564 (1951).

[43] 1 WITKIN, *op. cit. supra* note 36, at 273-274.

[44] Handyspot Co. v. Buegeleisen, 128 Cal. App. 2d 191, 274 P.2d 938 (1954); 3 CORBIN, CONTRACTS § 568 (1951).

[45] Kaye v. Tellsen, 129 Cal. App. 2d 115, 118, 276 P.2d 611, 613 (1954): "Where a contract of sale of a business has no restriction on the right of the seller to continue or re-engage in the same character of business, an agreement not to do so will not be implied from the sale of the goodwill. . . ."

[46] 6A CORBIN, CONTRACTS § 1386 (1962).

Corbin suggests a further rationale for implying an agreement not to solicit old customers directly. The implied promise in *Bergum v. Weber* "might be regarded as identical with a purely legal duty against unfair competition."[47] A legal duty would not be considered inconsistent with the express covenant; the court would assume that the parties did not intend to countenance unfair competition.

It is not difficult to understand the court's rationale in holding that the covenant of good faith was violated by the seller's active solicitation of his old customers. One who sells a business with its good will sells the expectation that an established clientele will continue to patronize the business.[48] Certainly this expectation figured in the selling price. To allow the seller to entice away his former customers by dircet solicitation would be to deprive the buyer of a primary benefit for which he bargained and paid.[49]

Not so easy to understand is the court's reasoning in *Harrison.* The court does not explain how the rationale of *Bergum v. Weber* applies to the facts of *Harrison.* The cases are similar in one respect only: both found that the seller breached not his express covenant but his implied covenant not to deprive the buyer of the benefits of the contract. Here any similarity ends. In *Bergum* the seller actively and directly solicited former customers; in *Harrison* the seller loaned money and guaranteed one account. Assuming that all contracts contain an implied covenant of good faith, it is arguable that Cook's loaning money was in no way similar to the active solicitation of former customers by the seller in *Bergum.*

The conclusion that Cook violated an implied covenant of good faith by loaning money to a competitor may be challenged on the grounds that an implied covenant of good faith does not encompass a promise to refrain from loaning money to (or guaranteeing an account for) a competitor. Courts have long held that a loan of money does not constitute breach of a noncompetition covenant, express or implied, and they hesitate to imply an obligation unless certain conditions exist.

In *Cousins Inv. Co. v. Hastings Clothing Co.* the court summarized the rules bearing on a court's right to imply covenants:

> (1) the implication must arise from the language used or it must be indispensable to effectuate the intention of the parties; (2) it must

[47] 3 CORBIN, CONTRACTS § 568 (1951).

[48] 6A CORBIN, CONTRACTS § 1385 (1962).

[49] Tobin v. Cody, 343 Mass. 716, 722, 180 N.E.2d 652, 656 (1962), quoting from an earlier case holding that the reason for implying a covenant not to compete when a business and its good will have been sold is "'that it is necessary to give the purchaser what is sold to him' (emphasis supplied)." *Cf.* Denawetz v. Milch, 407 Pa. 115, 178 A.2d 701 (1962).

> appear from the language used that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it; (3) implied covenants can only be justified on the grounds of legal necessity; (4) a promise can be implied only where it can be rightfully assumed that it would have been made if attention had been called to it; (5) there can be no implied covenant where the subject is completely covered by the contract.[50]

These rules were adopted by the California Supreme Court in *Lippman v. Sears, Roebuck & Co.*[51] Following these rules a court will be hesitant to imply a promise to do or refrain from doing a specific act. In *Foley v. Euless*,[52] for example, a packer agreed to process raisins delivered by a group of growers. The contract prohibited him from accepting raisins from other growers but did not expressly obligate the contracting growers to deliver any certain quantity of their crop. When the packer complained that only a small part of the crop was delivered, the court held that the growers had no implied obligation to deliver any raisins.[53] Quoting the decision of the district court of appeal, the supreme court stated: "Where parties have entered into written engagements which industriously express the obligations which each is to assume . . . the presumption is that having expressed some they have expressed all of the conditions by which they intended to be bound."[54] Though the result is questionable, it shows the length to which a court will go to avoid implying an obligation.[55]

Even though it be conceded that every contract contains a covenant of good faith, it is apparent that California courts have been hestitant to construe this covenant so as to impose unexpected obligations on a party. A court must first find that the implied covenant (1) meets the five-fold prerequisites outlined above and (2) is not inconsistent with or contradictory to any express obligation. Cook's express covenant in *Harrison* would not be inconsistent with an implied covenant against loaning money. But it is not at

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50 45 Cal. App. 2d 141, 149, 113 P.2d 878, 882 (1941).

51 44 Cal. 2d 136, 142, 280 P.2d 775, 779 (1955).

52 214 Cal. 506, 6 P.2d 956 (1931).

53 *Cf.* Milton v. Hudson Sales, 152 Cal. App. 2d 418, 313 P.2d 936 (1957), noted in 10 HASTINGS L.J. 99 (1958).

54 214 Cal. at 512, 6 P.2d at 958.

55 See also Tanner v. Olds, 29 Cal. 2d 110, 173 P.2d 6 (1946); Tanner v. Title Ins. & Trust Co., 20 Cal. 2d 814, 129 P.2d 383 (1942); Taylor v. National Supply Co., 12 Cal. App. 2d 557, 56 P.2d 263 (1936); Loyalton Co. v. California Co., 22 Cal. App. 75, 113 Pac. 323 (1913). 60 HARV. L. REV. 648 (1947), commenting on the *Tanner* cases, suggests that where a restrictive covenant may not be implied because the subject is expressly dealt with in the contract, the court might reach a different result by invoking the implied covenant that neither party will do anything to injure the rights of the other to receive the fruits of the contract.

all clear that his covenant could meet the other requirements. Among the five-fold prerequisites for implying a covenant are:

(1) its practical and legal necessity; (2) the tacit intention by both parties to deem the obligation part of the contract; and (3) lack of an express covenant completely covering the subject matter of the alleged implied covenant.[56]

On this last prerequisite, an implied covenant not to loan to a competitor might be considered excluded by the express non-competition covenant in *Harrison*, since the latter may have been intended as the entire agreement on the subject of future competition. Loans to competitors not specifically prohibited, an implied covenant could not be raised to forbid them. Even assuming that the express covenant did not thus exclude an implied covenant against loans, such a covenant would have difficulty meeting requirements 1 and 2. *Harrison*, therefore, has gone further than previous California cases in implying an obligation on part of a seller who agrees not to compete.

B. *The Dowd Case: Makeweight*

To bolster its theory that loaning money to a competitor violated the implied covenant of good faith, the court chose *Dowd v. Bryce*[57] as the case best representing that principle. In *Dowd* the covenant was broader than in *Harrison*. The sellers agreed to not "directly or indirectly, engage in similar businesses . . . nor knowingly, to sell any land" to a potential competitor.[58] Further they promised not to "do or cause to be done, any wilful act or thing to the prejudice of said trades or businesses . . . ."[59] Later the sellers brought an action for declaratory judgment to determine whether a lease to a person intending to compete with buyers would violate their covenant. Even though the restriction on selling land might be an invalid restraint on alienation, this specific prohibition showed that the parties intended a general restriction on acts which would promote competition. The court held that a lease by sellers to an acknowledged competitor would fall within the broad scope of prohibited competition and be a direct violation of the covenant.

The court, however, also based its decision on the theory that the sellers would be guilty of *indirect* competition if they

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[56] Cousins Inv. Co. v. Hastings Clothing Co., 45 Cal. App. 2d 141, 149, 113 P.2d 878, 882 (1941); see text accompanying note 50, *supra*.

[57] 95 Cal. App. 2d 644, 213 P.2d 500, 14 A.L.R.2d 1329 (1950).

[58] *Id.* at 645, 213 P.2d at 500.

[59] *Ibid.*

leased property to a competitor. The sellers would know that the lessee was paying rent out of profits made from competition. "By his very act of leasing [seller] creates competition. His act is one link in the chain which creates the very competition which it was the object of the clause in question to prevent."[60] Since the court had already decided that leasing would be a direct violation of the agreement, it was unnecessary to find that leasing was indirect competition.

It is strange that the court could find that *Dowd* "points to the conclusion" that loaning money violated the seller's implied covenant of good faith. *Harrison* can be easily distinguished. Cook's covenant that he would "not establish or conduct" a competing business was not as broad a restriction as that in *Dowd*, which specifically prohibited sale to a competitor. The agreement was directed at keeping Cook himself from competing. Unlike the seller in *Dowd*, Cook could have sold or leased land located next door to his old business to a potential competitor without breaching his promise. But most significant is that *Dowd* makes no mention at all of the implied covenant of good faith upon which the *Harrison* decision rests four-square.

While the court does not explain its reasoning, it apparently was most impressed by *Dowd's* emphasis on the voluntariness of seller's entering into a lessor-lessee relationship with a competitor, knowing that he would get his rent out of the competitors profits. But the crux of the *Dowd* decision was the court's recognition that the sellers had expressly covenanted not to sell land to a competitor. This, said the court, meant that the seller agreed not to do anything to promote competition, including lease property to a competitor. In *Dowd* the sellers did exactly that, thus directly breaching their express agreement.

If anything, the *Dowd* case is less persuasive than *Bergum v. Weber*. In neither the *Bergum* or *Harrison* cases did the seller breach his express covenant; thus the decisions had to rest on breach of an implied covenant. But in *Dowd* the seller clearly breached his express covenant, and the court had no occasion to invoke an implied obligation. The court's reliance in *Harrison* on the *Dowd* case is thus subject to question on the ground that the factual situations are so different that they call for application of different principles of law.

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60 *Id.* at 647, 213 P.2d at 502.

CONCLUSION

None of the cases, either California or other, anticipated the decision in *Harrison*. Cases from foreign jurisdictions almost universally take the position that a seller who loans money to a competitor or guarantees an account does not violate his noncompetition covenant. The court, in accepting the buyer's agrument that an implied covenant forbade such a loan, casts doubt on the meaning of the standard covenant not to compete. Such a covenant usually purports to prohibit only carrying on or engaging in competitive business, directly or indirectly.[61] If courts may imply a further obligation by the seller to refrain from even a tenuous connection with a competitor, the buyer gets more than he bargained for, while the seller inadvertently gives up important rights he never contemplated parting with.

To obviate this uncertainty attorneys may resort to drafting more explicit agreements, expressly setting out the activities permitted and prohibited to the seller. A covenant might, for example, specify that the seller may not loan money to a competitor, or do other acts not ordinarily thought of as competition. But prohibiting such activities might restrain trade or business in a manner not permitted by Business and Professions Code Section 16601. This section allows only covenants against "carrying on a similar business." Any agreement which goes beyond the terms of the section would be a restraint on trade subject to being voided under Business and Professions Code Section 16600.[62]

If *Harrison's* rationale is to be applied in the future, the seller of a business would be well advised to examine carefully his relations with present and potential competitors of his buyer. So long as a noncompetition agreement may be so liberally interpreted, the seller can never be certain whether he is staying within the bounds of his agreement. Where the purchase price of a business may be at stake, the seller and buyer are entitled to more precise guidelines.

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61 CONTINUING EDUCATION OF THE BAR, THE STATE BAR OF CALIFORNIA, ADVISING CALIFORNIA BUSINESS ENTERPRISES 1002 (1958).

62 See California Linoleum & Shades Supplies, Inc. v. Schultz, 105 Cal. App. 471, 474, 287 Pac. 980, 981 (1930): "Contracts in restraint of trade are not favored in law beyond the extent to which they are authorized by statute and the scope is not to be extended by a construction which imports into them a meaning which cannot be found in the language of the contract."