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MONTANA'S LAW REGARDING CONTRACTS IN RESTRAINT OF TRADE

The purpose of this paper is to investigate and discuss the law of Montana as it relates to contracts in restraint of trade with particular emphasis on the application of Montana statutes and a review of all Montana decisions in this area of the law. While the paper will deal with contracts in restraint of trade generally, the focus of the paper will be on covenants not to compete since the vast majority of such contracts involve agreements of this type. The treatment of this area of the law will not cover in any detail two factors which will always affect contracts in restraint of trade, namely, price-fixing and monopolies. The Montana Constitution declares an absolute prohibition on contracts which have as their end the fixing of prices[1] and the implementing legislation for that provision[2] makes contracts which tend toward the making of a monopoly illegal. Any contract held to be within the purview of these provisions of the Montana law would be unenforceable as a matter of law. Since the Montana decisions in this area are few in number, cases from other jurisdictions having similar statutes will be examined to highlight problem areas not yet solved by the Montana court.

Contracts which are in restraint of trade may be defined as any agreement by whch a person's right to do business is in any way limited as to character, place, manner and time.[3] Such contracts can arise in a myriad of situations as, for example, one's promise not to carry on his trade, not to sell or buy goods except at a specified price, not to produce specified goods, not to work as a carpenter and not to practice as a doctor or lawyer.[4] Perhaps the key factor in determining whether a contract is or is not in restraint of trade is competition. All contracts in restraint of trade have as their end the elimination of competition in one form or another and it is this factor which has traditionally bothered courts in allowing such contracts to be strictly enforced.

The very nature of these contracts, that of elimination of competition, indicates that injunction is usually the only remedy which would be effective to give the promisee the desired result from his contract. In the many cases decided to date the vast majority involve an attempt by the promisee to enjoin the promisor from carrying on certain activities in violation of contract terms. An additional problem which leads to the use of the remedy of injunction is the difficulty in determining damages for the breach of restrictive covenants. The direct effect on one's business resulting from competition by one person would be difficult to show and costly to determine at best.

[1]Montana Constitution, Art. XV, sec. 20.
[2]Sec. 94-1104, REVISED CODES OF MONTANA, 1947, hereinafter cited as R.C.M.
[3]Williston on Contracts, Rev. Ed., sec. 1633, hereinafter cited as Williston.
[4]6A Cordin on Contracts, sec. 1384, hereinafter cited as Corbin.

The fact that most promisees sought injunctions to remedy breaches of contracts in restraint of trade brought early courts face to face with the principal problems affecting such agreements. If the promisor is forced to abide strictly by his contract he may very well lose his means of earning a livelihood and become a public charge. In addition, the public would be deprived of his services and the lack of competition which may ensue could have the effect of driving prices up and allowing firms to create monopolies. These possible results indicate the presence of a strong public interest in whether or not such contracts are allowed strict enforcement. As in other areas, e.g. wages and hours legislation, freedom of contract has not been thought a sufficient basis on which to sustain every contract which may restrain trade.

Early English courts considered such contracts so harmful that they were denied enforcement altogether.[5] However, developing commerce forced courts to take a more lenient attitude towards such agreements and in so doing courts began to balance the social utility of such contracts with the possible harmful effects on the promisor and the public generally should they be strictly enforced. From totally denying enforcement English courts moved to a position of enforcing a covenant in restraint of trade if it was limited in space and did not apply to the entire realm.[6] Increased willingness on the part of courts to inquire more fully into possible justifications for the use of contracts in restraint of trade in particular fact situations caused this general-partial distinction to give way to a new theory, the now famous "rule of reason."

Thus in an early English decision the court upheld a covenant not to compete ancillary to the lease of a bake shop which provided that the lessor would not practice his trade for the term of the lease in the parish where the bake shop was located.[7] This important decision has been cited as formulating for the first time the "rule of reason" by which the validity of contracts in restraint of trade is now judged by American courts, and which has found application in interpreting present-day anti-trust legislation.[8]

The approach of the rule of reason takes into consideration possible harm to the public as well as the promisor should the contract be enforced and American cases generally require, in the case of a restrictive covenant, that it be ancillary to some other lawful transaction to be enforceable.[9] Additional requirements imposed are that the contract or cov-

[5]Blake, Harlan M., EMPLOYEE AGREEMENTS NOT TO COMPETE, 73 Har. L. Rev. 625, 630 (1960).

[6]Rogers v. Parrey, 2 Bulst. 136, 80 Engl. Rep. 1012 (K.B. 1613).

[7]Mitchel v. Reynolds, 1 P.Wms. 181, 24 Eng. Rep. 347 (Q.B. 1711).

[8]Blake *supra,* note 5 at 628.

[9]Williston, sec. 1639; Restatement of Contracts, sec. 515(e), hereinafter cited as Restatement.

enant must be necessary to protect the promisee and be no more restrictive than is absolutely necessary to insure such protection. The principal factors which bear upon the reasonableness of the contract are the area the restriction is to cover and the length of time it is to remain in force. In both instances the court must be impressed with the reasonableness of the restriction if the covenant is to be strictly enforced.[10] As with other contracts, factors such as grossly inadequate consideration, duress, undue hardship on the promisor, etc. may militate against the granting of an injunction to enforce the contract even though the literal terms of the restriction would allow enforcement under other circumstances.[11]

American courts, using the test of reasonableness, grant enforcement to contracts in restraint of trade in many different situations. Justice Taft summarized these instances in an early American decisions, *United States v. Addyston Pipe, etc. Co.*:[12]

(1) A covenant from the seller of property to the buyer not to complete so as to reduce the value of the property sold.

(2) By a retiring partner not to compete with the firm.

(3) By a pending partner not to compete with the firm.

(4) By a buyer of property not to use the same in competition with a business retained by the seller.

(5) By an agent, servant or assistant not to compete with his employer after termination of the employment.

Thus, except where statutes may modify the general rule, one can expect courts to uphold contracts in restraint of trade if the promisee can demonstrate that the restriction on the promisor is necessary to protect his enjoyment of the fruits of the contract and is narrow enough so as not to unreasonably restrict the activities of the promisor.[13]

[10]The reader's attention is directed to four extensive annotations discussing this problem in great detail in two connections, employee agreements not to compete after examination of employment and employee agreements not to compete ancillary to the transfer of a business, profession, etc. See Annot., Enforceability of covenant against competition, ancillary to sale or other transfer of business, practice, or property, as affected by duration of restriction, 45 A.L.R.2 77, (1956); as affected by territorial extent of restriction, 46 A.L.R.2 119 (1956). Enforceability of restrictive covenant, ancillary to employment contract, as affected by duration of restriction, 41 A.L.R.2 15 (1955); as affected by territorial extent of restriction, 43 A.L.R.2 94 (1955). Each of these annotations spans over two-hundred pages and discusses the law relating to contracts in restraint of trade generally.

[11]Williston, sec. 1639; Restatement, sec. 515 (b).

[12]85 F 271, affm'd., 175 U.S. 211 (1898).

[13]The Restatement of Contracts in sections 513 to 518 sets out the law in this area generally with specific examples of the types of agreements which most courts find enforceable.

513. A bargain is in restraint of trade when its performance would limit competition in any business or restrict a promisor in the exercise of a gainful occupation.

514. A bargain in restraint of trade is illegal if the restraint is unreasonable.

515. A restraint of trade is unreasonable, in the absence of statutory authorization or other justification, if it

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Present Montana law regarding contracts in restraint of trade differs from the country generally due to the presence of sections 13-807, 13-808, and 13-809, Revised Codes of Montana, 1947. Since, as mentioned before, the vast majority of reported cases involving contracts in restraint of trade concern covenants not to compete, a reading of the above-cited statutes will immediately indicate their obvious effect on the field of law generally:

> *13-807* Any contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than is provided for by the next two sections, is to that extent void.
> *13-808* One who sells the good will of a business may agree with the buyer to refrain from carrying on a similar business within a specified county, city, or part thereof, so long as the buyer, or any person deriving title to the good will from him, carries on a like business therein.
> *13-809* Partners may, upon or in anticipation of a dissolution of the partnership, agree that none of them will carry on a similar business within the same city or town where the partnership business has been transacted, or within a specified part thereof.[14]

(a) is greater than is required for the protection of the person for whose benefit the restraint is imposed, or
(b) imposes undue hardship upon the person restricted, or
(c) tends to create, or has for its purpose to create, a monopoly, or to control prices or to limit production artificially, or
(d) unreasonably restricts the alienation of use of anything that is a subject of property, or
(e) is based on a promise to refrain from competition and is not ancillary either to a contract for the transfer of goodwill or other subject of property or to an existing employment or contract of employment.
516. The following bargains do not impose unreasonable restraint of trade unless effectuating, or forming part of a plan to effect, a monopoly:
(a) A bargain by the transferor of property or of a business not to compete with the buyer in such a way as to injure the value of the property or business sold;
(b) A bargain by the buyer or lessee of property or of a business not to use it in competition with or to the injury of the seller or lessor;
(c) A bargain to enter into a partnership with an actual or possible competitor;
(d) A bargain by a partner not to interfere by competition or otherwise with the business of the partnership while it continues, or subject to reasonable limitations after his retirement;
(e) A bargain to deal exclusively with another;
(f) A bargain by an assistant, servant, or agent not to compete with his employer, or principal, during the term of employment or agency, or thereafter, within such territory and during such time as may be reasonably necessary for the protection of the employer or principal, without imposing undue hardship on the employee or agent.
518. Where a promise in reasonable restraint of trade has added to it a promise in unreasonable restraint of trade, the former promise is enforceable unless the entire agreement is part of a plan to obtain a monopoly; but if full performance of a promise indivisible in terms, would involve unreasonable restraint, the promise is illegal and is not enforceable even for so much of the performance as would be a reasonable restraint.

[14]These statutes have been extant in Montana since the Civil Code of 1895. They were taken from the Civil Code of California and originated as sections 833-835 of the Field Civil Code.

Section 13-807 effectively eliminates employee covenants not to compete from the Montana law.[15] Courts which have been called on to construe such agreements in the light of this statute, all from other jurisdictions having the same or similar legislation, have uniformly held that the statute means what it says and such agreements are per se void regardless of the reasonableness of the restraint or the justification therefor.[16]

Section 13-808 merely codifies the common law rule regarding agreements not to compete ancillary to the sale of a business with good will involved. Courts have long recognized such covenants as necessary in order to insure that good will is actually transferred, and that the transferor is not permitted at some later time to effectively retrieve that which he has sold by entering into competition with his former business in the same location. The section indicates that the reasonableness requirement for such a covenant not to compete will be satisfied as long as it is confined to a specified county, city or a part of either, and is to last no longer than a period during which the buyer, or any person deriving title to the good will from him, carries on a "like business" within the area specified. The statutory provisions as to time here would in all probability permit the covenant to endure longer than would be permissible in states following the common law rule. It is doubtful whether, after the lapse of some years from the sale, a business would need to be protected from competition by the seller in order to protect its good will.

Section 13-809 again codifies to a large extent the common law rule regarding agreements not to compete ancillary to the dissolution of a partnership.[17] The language of this section raises some problems which the cases do not discuss, but which could cause confusion. A literal reading of the statute would indicate that the agreement not to compete would have to extend to *all* of the partners involved. If this is true it is difficult to perceive just how such an agreement would be of any value. Why would all the members of a partnership agree that if the partnership should be dissolved (an event which none of them could control individually) they would all leave town? It seems more likely that such a restrictive covenant would be required of a new partner by firm members who were more established or had a greater financial interest in the firm. Its purpose would be to prevent a new partner from entering the firm, using its facilities and good will to establish his own reputation, and then leaving the firm taking the firm's customers with him. If this situation was envisaged by the drafters of this code section it is suggested that it can

[15]There are two exceptions to this general prohibition which will be discussed *infra*.

[16]*See*: E. S. Miller Laboratories, Inc. v. Giffin, 200 Okla. 398, 194 P.2 877 (1948); in Morris v. Harris, 127 Cal. App.2 476, 274 P.2 22, 23 (1954) the court noted that cases from jurisdictions having no statute similar to 13-807 would be of no assistance in determining whether or not an employee covenant not to compete would be enforced.

[17]Williston, sec. 1644.

not be accomplished without doing violence to the wording of the statute as it now stands. Three states have recognized this problem and have substituted the words "all or some of them" (or their equivalent) for "none".[18] In litigated agreements of this type (covenants not to compete ancillary to partnership dissolutions) the decisions have often turned on whether there was a sale of good will involved in the partnership agreement rather than whether the agreement was valid solely by reason of being within the wording of 13-809.[19] This could be explained by a reluctance on the part of both courts and counsel to become embroiled in interpreting the literal wording of this statute.

The area limitations of 13-809 are much narrower than is the case for the section dealing with the sale of a business and restricts the covenant to a city or town rather than extending to a county. California has had problems with this unexplained difference in area limitation[20] and in 1961 the California code was amended to make the space limitations the same for both the sale of a business and the dissolution of a partnership.

Another problem area in this statute is the lack of a time limit for the effectiveness of a covenant not to compete ancillary to the dissolution of a partnership. Despite this lack of a time limitation the litigated cases from both Montana and jurisdictions having similar statutes indicate that drafters usually feel constrained to include a reasonable time limitation.[21] It seems not unreasonable to argue that since the common law is in effect in Montana unless replaced by statute the common law limitation on covenants not to compete, that they be limited to some reasonable time, is still applicable despite the lack of same in section 13-809.

It seems apparent that with the exception of employee covenants not to compete Montana courts can be expected to follow the general American rule validating contracts in restraint of trade if they are reasonable. The two exceptions provided to the general prohibition against contracts restraining a person from engaging in a lawful business or profession embrace an area of the law of contracts in restraint of trade in which there is a great deal of activity if the number of reported cases are any indication.[22] In California, a state which has provisions similar to those in Montana,[23] the following contracts which are obviously in restraint of trade have been sustained: a covenant not to use trade secrets, a covenant

[18]North Dakota Code, sec. 9-08-06 (2); Florida Statutes Annotated, sec. 542.12 (3); California Business and Professions Code, sec. 16602.

[19]See Brown et al. v. Stough, Okla., 292 P.2 176 (1956).

[20]Anderson Crop Dusters, Inc. v. Matley, 159 Cal. App.2 811, 324 P.2 710 (1958).

[21]*Brown v. Stough, supra,* note 19, two years; Anderson Crop Dusters v. Matley, 159 Cal. App.2 811, 324 P.2 710 (1958), five years; Jenson v. Olson, 144 Mont. 224, 395 P.2 465 (1964), nine years.

[22]See generally Annot., Statutes prohibiting restraint on profession, trade, or business as applicable to restrictions in employment or agency contracts in 3 A.L.R.2 522 (1949).

[23]See note 46 *infra.*

restricting the use of property sold on conditional sales contracts, a covenant limiting the use of leased property, a covenant for the exclusive right to sell a particular product, and an agreement *not* to manufacture a house trailer.[24] It is submitted that should the Montana court be presented with parallel situations it would reach similar results.

Research has disclosed seven reported cases in which the Montana Court has ruled on the validity of a contract alleged to be in restraint of trade or in dicta has indicated the feelings of the Montana Court towards enforcing such agreements. The paucity of decisions will permit a brief analysis of each.

The first mention by the Montana court of its attitude concerning contracts in restraint of trade came in the case of *Ford v. Gregson,* an 1887 decision.[25] Involved there was a contract by which persons purportedly bound themselves not to sell water rights on a certain stream to others who were trying to buy up the rights. The court found the contract void on two grounds. The first was a provision which had as its purpose preventing the parties from compromising or settling any litigation which might arise concerning the water rights in question. Such a provision was held to be against the policy of the law. The court also found the contract void as being against public policy in that it contained a prohibition on the sale of the water rights which extended to the heirs and legal representatives of the parties signatory to the contract. The court characterized such an agreement as analogous to a contract in restraint of trade.

> "They are against public policy and void . . . A covenant in restraint of trade generally will not be supported, although founded on a good consideration (citing cases). It is true that a covenant not to trade in a particular place, and for a particular itme, is good."[26]

The court indicated its recognition of the general-partial distinction characteristic of early decisions in the area, tempered by a general reluctance to accept such contracts due to the supposed harm to the public from their enforcement.[27]

In *Newell v. Meyendorff*[28] the plaintiff had given the defendant an exclusive sales contract for its cigars in Montana and then brought suit for the value of cigars provided the defendant pursuant to the contract. The defendant, in recoupment, alleged a breach of the exclusive sales contract by the plaintiff and plaintiff countered by claiming that the contract was in restraint of trade and therefore void. The lower court

[24]See, 26 So. Cal. L. R. 208 (1953) and cases there cited.

[25]7 Mont. 89, 14 P. 659 (1887).

[26]*Id.* at 98.

[27]There is some language in the decision which indicates that counsel may have viewed the restriction on alienation as a restraint of trade and have argued its invalidity on that basis. *Id.* at 98.

[28]9 Mont. 254, 23 P. 333 (1890).

agreed with plaintiff and gave leave to the defendant to amend his answer. Defendant then pleaded the contract as a complete bar on the ground that if the contract was void plaintiff could have no recovery on it. The Supreme Court noted the general rule that contracts in restraint of trade were void as against public policy declaring such rule to be "among our most ancient common law inheritances".[29] The court also noted the exception granted in favor of contracts restraining trade which were limited as to time or place, these being susceptible of enforcement. In listing the reasons for the rule the court quoted approvingly from an early English case and indicated their apprehension at the possible adverse effects to both the promisor and the public in general which might arise from enforcing such contracts.[30] However, the court looked on this exclusive selling agreement as being limited in both place and person and not having the effect of preventing defendant from carrying on his trade or business. It was therefore not in restraint of trade and could be enforced. Unfortunately for plaintiff, the court also held that since it had alleged the contract to be void below it could not claim its enforceability on appeal and the cause was remanded for a new trial.[31]

In *Schwanekamp v. Modern Woodmen of America*[32] the court upheld a clause in a contract of insurance which purpoted to void the insurance contract should the insured at any time engage in the sale of liquor. The suit here was to collect death benefits under the policy and the defense was that the insured had at one time worked as a bartender. The claimant alleged that the clause was void in that it violated the predecessor of 13-807 and prevented the insured from engaging in a lawful occupation. The court rejected such a contention holding that it was entirely reasonable for insurers to limit the types of occupations which their insureds could follow. For the same reason that insurers could prevent insureds from working with nitroglycerine and dynamite the defendant could prevent claimant's decedent from working as a bartender by the terms of the insurance contract. Section 13-807 had no application to this type of contract said the court.

[29] *Id.* at 259.

[30] "(1) Such contracts injure the parties making them, because they diminish their means of procuring livelihoods, and a competency for their families. They tempt improvident persons, for the sake of present gain, to deprive themselves of the power to make future acquisitions, and they expose such persons to imposition and oppression. (2) They tend to deprive the public of the services of men in the employment and capacities in which they may be most useful to the community as well as themselves. (3) They discourage industry and enterprise, and diminish the products of ingenuity and skill. (4) They prevent competition, and enhance prices. (5) They expose the public to all the evils of monopoly; and this especially is applicable to wealthy companies and large corporations, who have the means, unless restrained by law, to exclude rivalry, monopolize business, and engross the market. Against evils like these, wise laws protect individuals and the public, by declaring all such contracts void." *Id.* at 260.

[31] For a modern decision in the same vein see Thomas v. Belcher, et al., 184 Okla. 410, 87 P.2 1084 (1939).

[32] 44 Mont. 526, 120 P. 806 (1912).

In a 1920 case[33] the plaintiff had sold all his shares of stock in a corporation he had formed to transport tourists into Yellowstone Park (plaintiff being the sole stockholder and operator of the business) to defendants. Shortly thereafter he executed the agreement which was the subject of this suit in favor of the defendants. In it he agreed to transfer all his good will to the new corporation and promised not to go into business in Yellowstone Park forever. There was also a provision indicating that compensation would be paid for his "assistance" to the new corporation and the agreement was made terminable at the will of either of the parties to it. Some eight years later plaintiff brought the instant suit to recover compensation allegedly due under the contract. The defense was that the contract was void as violating what is now 13-807 and 13-808, and that since plaintiff at the time of the agreement had no goodwill to sell the agreement was void for lack of consideration. The court ignored the issue of whether or not the covenant not to compete was valid by holding that a stockholder in a corporation has no interest in the goodwill of the corporation which he can sell and that even if he did such goodwill would pass with the sale of the stock and could not be transferred independently as was here attempted. While not so held here, it is inferable from this decision that an agreement not to compete ancillary to the sale of stock of a corporation would not be valid in Montana under 13-808.[34]

A suit to cancel an oil and gas lease[35] caused the Montana court to construe a contract between the lessee's assignee and a gas distributing company which provided that 1/3 of all the natural gas to be used in two Montana towns should come from the leased property for five years, and that during this period the lessee was not to sell gas to any other persons within the market area. Defendant urged this contract upon the court as evidence of the fulfillment of its duty under the lease to actively market any gas which was produced on the leased property. Plaintiff's contention was that this agreement created a monopoly, was in restraint of trade and was therefore void and of no effect in sustaining the defendant's claim of performance of the lease requirements. Plaintiff relied on Article XV section 20 of the Montana Constitution and sections 10901 (94-1104) and 7559 (13-807) Revised Codes of Montana (1921). The court rejected the idea of per se illegality of the contract under the above provisions and quoted approvingly from an earlier Montana decision[36] to the effect that the framers of the Montana Constitution did

[33]Wylie v. Wylie Permanent Camping Co., 57 Mont. 115, 187 P. 279 (1920).

[34]While California subscribes to this view also, Chamberlain v. Augustine, et al., 172 Cal. 285, 156 P. 479 (1916), another state with similar statutory provisions holds that a stockholder in a corporation has a proportionate interest in the goodwill of same which will support a covenant not to compete ancillary to the sale of the stock. Key et al. v. Perkins, 173 Okla. 99, 46 P.2 530 (1935). *Accord*, Restatement, sec. 516 (a). Such a transaction is permitted by statute in California, sec. 16601 California Business and Professions Code and in Florida, Florida Statutes Annotated sec. 542.12 (2).

[35]Stranahan v. Independent Natural Gas Co., 98 Mont. 597, 41 P.2 39 (1935).

[36]Great Northern Utilities Co. v. Public Service Commission, 88 Mont. 180, 293 P. 294 (1930).

not intend by their language to void every contract which might in some peripheral way tend toward monopoly or restraint of trade, but intended only to forbid those contracts which "unlawfully take advantage of the public".[37] The opinion went on to say that in each instance the court should look closely at the facts of the particular case and the form and nature of the arrangement or combination complained of to determine whether the public was being unlawfully taken advantage of.[38] It is submitted that the rule enunciated by the court in reversing the nonsuit here is actually a restatement of the "rule of reason" so often used in this area of the law.

In *Leiman-Scott, Inc. v. Holmes*[39] the court upheld a covenant by the seller of a business and goodwill not to compete with the buyer *in Idaho and Western Montana.* (Emphasis supplied) The suit here was by the seller for the purchase price and buyer defended on grounds of breach of the covenant not to compete by the seller within the specified territory. The lower court nonsuited the plaintiff. The Supreme Court held the subsequent competition by the seller not to be a complete defense but ruled that the loss of business due to such competition might be pleaded as a counterclaim to reduce seller's recovery on the contract. The basis of the court's holding was in part that a seller could not interfere with goodwill transferred and in part that seller had breached his restrictive covenant not to compete. The question of the validity of that covenant was apparently not presented to the court and they did not consider it in the opinion. It would seem that seller here could possibly have avoided this reduction in his recovery, or at least minimized the same, by alleging that the covenant not to compete violated section 13-808. That section limits covenants ancillary to the sale of a business to a *county* and the instant agreement extended to Idaho and Western Montana. Seller could thus argue that he could not lawfully have been restrained from competing in the larger area specified in the agreement, that the restrictive covenant was void en toto, and that buyer could not base his damages on breach of a void covenant. Courts in other jurisdictions having similar statutes have regularly held such covenants totally invalid when they were framed too broadly,[40] and at most have only enforced the covenant to the extent permitted by the statute.[41]

The most recent Montana case in this area[42] involved a wholesale and retail ice cream business which had been operated as a partnership. The partnership was dissolved with each partner taking one phase of the business and covenanting not to compete with each other in the city

[37]Stranahan *supra,* note 35 at 610-611.
[38]*Id.*
[39]142 Mont. 58, 381 P.2 489 (1963).
[40]Dubois et al. v. Padgham, 18 Cal. App. 298, 123 P. 207 (1912); Anderson Crop Dusters, Inc. v. Matley, 159 Cal. App.2 811, 324 P.2 710 (1958).
[41]Wesley v. Chandler, 152 Okla. 22, 3 P.2 720 (1931).
[42]Jenson v. Olson, 144 Mont. 224, 395 P.2 465 (1964).

of Helena for nine years.[43] One of the partners sold his half of the business to plaintiff with no mention of the agreement not to compete being made in the agreement of sale. One year after the sale defendant began competing with plaintiff's business and two years later plaintiff brought this suit seeking damages and an injunction. The defense was that there had been an oral agreement between the partners shortly after the dissolution not to abide by the covenant not to compete.

The court first found the covenant valid as being within the statutory provisions 13-807 through 13-809. Such a covenant was a contract in restraint of trade said the court, and would be valid only in certain lines of enterprise and only if it was a reasonable restriction on the freedom to do business. Being confined to the city of Helena and to last nine years these requirements were held to be satisfied.[44] In line with the suggestion made supra that such agreements should contain a time limit although the statute does not formally require one, the court seemed to consider the length of time the covenant was to run as bearing on the reasonableness of the restraint.

Having found the covenant valid the court turned to the question of whether the covenant was transferred to plaintiff in the agreement of sale without being specifically mentioned, putting him in a position to enforce it in this action. The court cited the general rule that such covenants were assignable but rejected the idea that they would transfer automatically on the sale of a business and its goodwill. Such a covenant could be passed without a separate agreement if it could be shown that it was the intent of the parties to achieve that result.[45] The court felt in the instant case that the plaintiff had no knowledge of the covenant at the time of the sale, as evidenced by his delay in filing this suit after commencement of competition by the defendant. This fact negated any inference that the parties intended the covenant to pass with the agreement of sale and the court found that plaintiff had failed to prove its case regardless of whether or not defendant could, or should be allowed to, prove the alleged oral agreement not to abide by the covenant. The decision for defendant was affirmed.

The few Montana decisions in this area fail to raise many of the problems which exist. Decisions from several other jurisdictions having the same or very similar statutory provisions are useful in predicting

[43]Note again that while 13-809 does not require a time limit most agreements contain one.

[44]Jenson *supra*, note 42 at 227.

[45]*Id.* at 229.

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what the action of the Montana court would be if presented with these problem areas.[46]

A lease of real property may involve a contract in restraint of trade. In an Oklahoma case[47] the lessee of space in a shopping center obtained a covenant in the lease that the lessor would not lease other property in the center to stores which might carry lines of clothing in competition with the lessee. The lessor contended here that such a covenant violated the counterpart of 13-807. The Oklahoma court recognized that such a contract might in some "theoretical and incidental way indirectly restrict trade,"[48] but felt that the main purpose of the covenant was to increase and promote trade, thus justifying the court in holding it valid.[49]

Although Montana does have decisions dealing with the sale of a business and goodwill with a covenant not to compete by the seller, many additional problems concerning such covenants have arisen. Section 13-808 requires that these covenants be limited to such time as the buyer or a person purchasing the goodwill from him carries on a like business in the restricted area. In light of this, should covenants be enforced where there is no time limit stated for the prohibition against competition? This question was answered in the affirmative in an Oklahoma case which read the time limit of the statute into the contract.[50]

What result if the covenant not to compete ancillary to the sale of a business and goodwill comes from a person other than the seller? enforceable? Yes, said the Oklahoma court[51] where it can be shown that the covenant from the third party is necessary to the protection of the goodwill sold. Such a result however, does seem out of line with the literal wording of sec. 218 of the Oklahoma code (13-808), "One who sells . . . may agree with the buyer . . ." No, said the California court in striking down a covenant not to compete by the seller's husband in a community property state.[52] The court found the business, in which the husband participated, to belong solely to the wife, leaving the husband with no vendible interest in the goodwill to support his covenant not to compete.

The California court has held that where the contract is obviously one of employment, wording in the contract attempting to show a sale

[46]Similar statutes to 13-807—13-809 in other states are as follows:
California Business and Professions Code, sections 16600 through 16602.
Oklahoma Statutes, sections 217 through 219.
South Dakota Code, section 10.0706.
Florida Statutes Annotated, section 542.12.
Code of Alabama, Title 9, sections 22 through 24.
North Dakota Century Code Annotated, section 9-08-06.

[47]Utica Square, Inc. v. Renberg's Inc., Okla., 390 P.2 876 (1964).

[48]*Id.* at 881.

[49]*See generally,* Restatement, section 516.

[50]Clare v. Palmer, 200 Okla. 186, 203 P.2 426 (1949). Accord, Yost v. Patrick, 245 Ala. 275, 17 So.2 240 (1944).

[51]Griffin v. Hunt, Okla., 268 P.2 874 (1954).

[52]Balkema v. Deiches et al., 90 Cal. App.2 427, 202 P.2 1068 (1949).

of goodwill so as to support a covenant not to compete will be overlooked as an employee has no interest in goodwill.[53]

Can a person promising not to compete avoid his obligation by forming a corporation to carry on business? What result if the promisee has changed the form of the purchased business from a partnership to a corporation with a different name? A California court, in a case involving the sale of a photo finishing business and its goodwill, ruled that the words of the statute, "like business"[54] did not necessarily mean exactly the same business or a business with the same name, but refused to disregard the corporate entity and find that the promisor who had formed the corporation was merely its alter ego. Thus, while the promisor was enjoined from competing in the photo finishing business the corporation could continue to compete.[55]

Courts have different views on the question of whether a covenant not to compete will be implied from the sale of a business with its goodwill. California courts seem willing to not only imply such a covenant from the sale of the goodwill of a business, but also to imply the sale of goodwill in the same case from the sale of a business as a going concern.[56] The Alabama[57] and North Dakota[58] courts hold the opposite view implying neither the sale of goodwill from the sale of a business, nor a covenant not to compete from the sale of goodwill. In support of the California position it seems obvious that if a person buys a going concern he intends to receive, and to pay for, its goodwill. However, it seems a better rule to require a covenant not to compete to be specifically provided for in the contract if that is what the parties intend.

As pointed out supra the presence of section 13-807 seems to totally invalidate covenants not to compete after the termination of employment. Such agreements cannot be made to come within the two exceptions provided by 13-808 and 13-809. Thus, while these contracts are upheld generally in the United States if they are reasonable,[59] it would appear the Montana employer is without legal means to protect his business from competition by former employees whose intimate knowledge of his operations could be effectively used to work against him. However, in the area of trade secrets and customers lists there are several decisions upholding clauses in employment contracts which provide that the em-

[53]Haas v. Hodge, 171 Cal. App.2 478, 340 P.2 632 (1959).

[54]Section 16601, Cal. Bus. and Prof. Code; section 13-808, R.C.M.

[55]It should be noted that there were others besides the promisor actively engaged in running the corporation.

[56]Handyspot Co. of Northern California v. Buegeleisen, 128 Cal. App. 191, 274 P.2 938 (1954).

[57]Joseph v. Hopkins, 276 Ala. 18, 158 So.2 660 (1963).

[58]Brottman v. Schela, 52 N.D. 137, 202 N.W. 132 (1925); Hyashi v. Ihringer, 79 N.D. 625, 58 N.W.2 868 (1953).

[59]Corbin, sec. 1394; Restatement, sec. 516(f).

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ployee shall not disclose such lists or secrets or use the same to compete against his employer for some reasonable time after termination of employment.[60]

Courts in these cases seem to have no trouble disposing of the usual contention that such covenants prevent the promisor from engaging in a lawful trade or business and are therefore void under the counterpart of 13-807. The court's reasoning is usually to the effect that the promisor is not prevented from engaging in his trade or business, but is merely prohibited from pilfering his former employer's trade secrets or customer lists. The importance of trade secrets and customer lists to a business and the obvious need for the law to afford them some protection should argue well for the upholding of similar clauses by the Montana court should it face this situation.

Another problem arises when covenants extend to a greater territory than is permitted by the statutes or than is necessary for the promisee's protection. Will the court enforce that portion of the covenant which is allowed by the statute or consider the covenant totally invalid as being too broad?[61] Courts differ on this matter, the California courts generally take the position that the covenant is totally bad[62] while courts in Oklahoma seem ready to enforce the portion of the restriction which the statutes will allow.[63] Both courts seem ready to read the time limit of the statute into contracts which are silent concerning any limit.[64]

Acceptance of the concept of separability here could give rise to one objectionable side effect. If a court will curtail the limitations of the contract to satisfy the law there will be a tendency on the part of drafters of such covenants to make them extremely broad for the *in terrorem* effect upon the promisor. Such a tactic would in no way lessen the actual effect of the covenant and would perhaps provide some unwarranted benefits to the promisee. Adoption of severability thus seems contraindicated in this connection. Drafters of such covenants should be prevented from going beyond legal limits and denying enforcement to those covenants which do seems the surest way to achieve this end.

The fact that some contracts in restraint of trade would be enforced in one state but not another, principally employee covenants not to com-

[60]Gordon v. Wasserman, 153 Cal. App.2 328, 314 P.2 759 (1957). Collector-salesman not to use customers lists or disclose same for one year after termination of employment; Gordon v. Landau, 49 Cal.2 690, 321 P.2 456 (1958), collector-salesman not to use or disclose customer lists for one year after termination; State Farm Mutual Life Insurance Co. v. Dempster, 174 Cal. App.2 639, 344 P.2 821 (1959), life insurance agents prevented from interfering with policies or policy holders for one year afer termination of agency. *Also see* Corbin, sec. 1394.

[61]See generally, Corbin sec. 1387; Restatement sec. 518.

[62]Anderson Crop Dusters *supra,* note 40 and Dubois *supra,* note 40.

[63]Wesley v. Chandler, 152 Okla. 22, 3 P.2 720 (1931); Hartman v. Everett, 158 Okla. 29, 12 P.2 543 (1932).

[64]Clare v. Palmer, 201 Okla. 186, 203 P.2 426 (1949) and cases there cited.

pete, has naturally led to attempts on the part of drafters to provide that contracts should be construed under the law of some state where such covenants are enforceable. Such attempts have uniformly met with failure. Court utilize the forum's law to declare the agreements void notwithstanding contract provisions purporting to dictate choice of law rules for the court.[65]

CONCLUSION

While Montana cases in the area of contracts in restraint of trade are few, the number of litigated cases arising in other jurisdictions and the vast amount of material which has been written on the subject give lie to the idea that restrictive clauses are not in general use in the State of Montana. An informal survey of Montana lawyers conducted by the writer indicates that most lawyers contacted had some experience with such contracts and one has had considerable activity in the area of employee covenants not to compete during the past year. It does seem to be true that Montana activity in this area is limited to the larger cities and the steadily growing population of those cities would indicate that more litigation on the subject could be expected in the future. There is an indication that employee covenants not to compete are being used to some extent even though lawyers are fairly certain they would be unenforceable should litigation arise. The *in terrorem* effect is apparently thought to justify inclusion of such provisions.

States other than Montana which have similar statutory treatment of the subject report continuing lines of cases dealing with problems in this area. These decisions should provide satisfactory guidelines for the solution of problems arising in Montana. A survey of these decisions does indicate two areas where the Montana law as it presently exists should be changed.

Section 13-809, which allows the restriction of a person's exercise of a lawful trade, profession or business ancillary to a partnership dissolution agreement, would limit the territorial extent of a valid covenant to a city or town. The preceeding section, 13-808, limits such a covenant ancillary to the sale of the goodwill of a business to a county. No reason appears to justify this difference nor do the cases seem to provide any. It is therefore suggested that section 13-809 should be amended to make the territorial limit the same as that stated in 13-808. It has been noted *supra* that California took such action to amend its provision in 1961 after the California courts had struck down several covenants ancillary to the dissolution of partnerships which had been framed too broadly.

As indicated previously, it is submitted that the language of section

[65]Forney Industries, Inc. v. Andre, 246 F.Supp. 333 (D.ND 1965); Davis v. Jointless Fire Brick Co., 300 F. 1 (9th Cir. 1924); *See generally,* Annot., Conflict of laws as to validity, enforceability, and effect of ancillary restrictive covenant not to compete, in contract of employment or for sale of business in 70 A.L.R.2 1292 (1960).

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13-809 as it presently reads makes little sense. Addition of language to allow partnership dissolution agreements to extend to "some or all" of the partners involved and including a requirement for such agreements to include a reasonable time for their effectiveness would make the statute workable and perhaps of some value. A considerable question exists in the writer's mind as to whether or not allowing such restrictive covenants has any social value in the first place. Most partnerships involve professional people or small businessmen and little reason appears why the law should allow such covenants to be extracted (for it's hard to imagine a promisor desiring such an agreement) from these persons as a condition to joining a firm. The legislature has declared in section 13-807 that the public policy of Montana generally does not favor agreements limiting persons in the exercise of lawful trades or businesses. The argument for an exception in the case of partnership dissolutions seems to carry little weight.

It is also suggested that Montana's rule concerning the interest of a stockholder in the goodwill of a corporation as announced in Wylie is wrong as a general proposition and limitation on 13-808. While it may be true that the stockholder of a large public-issue corporation has no such interest it is certainly true that the owner/operator of a small corporation, so very prevalent in Montana, may be the very personification of the corporation's goodwill. It could in fact be the case that the public, in dealing with the business, is unaware that a corporate entity even exists. To hold that the seller of stock has no interest in the goodwill of the corporation to support a covenant not to compete on the sale of the stock is in many cases to ignore reality. It is hoped that should the Montana court face this situation again the Wylie holding, insofar as it announces such a rule, will be disapproved and such covenants be permitted when the facts indicate that the seller of stock does in fact have an interest in the goodwill of the corporation.

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