

Public Policy and Illegality

Many contract law doctrines like unconscionability and misrepresentation protect one party in an agreement from the other. In this section, the focus shifts to protecting the public from the terms agreed upon by both parties. The core question we will explore is when will a court refuse to enforce an agreement that was fairly and freely made because enforcement would violate “public policy”? A secondary question is what are the implications of such a finding on the parties’ rights?

Statutes sometimes prescribe that specific contracts are unenforceable. Anti-usury laws are examples of such statutes. Putting those relatively rare cases aside, unenforceable contracts due to public policy fall under two main categories. The first includes contracts that violate specific criminal laws, often called “illegal contracts.” As an agent of the state, courts obviously will not enforce—and will not provide any remedy for the breach of—a contract whose subject is the commitment of a criminal act. But, as you can expect, murder contracts are not subject to litigation. As we shall see, the more difficult question had to do with contracts that indirectly involve minor criminal offenses.

The second category of unenforceability due to public policy involves situations in which courts derive such policies from their understanding of other, non-criminal, social or legal norms. While courts can find such a violation of public policy in every context, the two most common contracts subject to such scrutiny are those regulating family relationships and those restricting trade. We will see examples of both.

Bovard v. American Horse Enterprises, Inc.

201 Cal.App.3d 832 (Court of Appeal, California. 1988)

PUGLIA, Presiding Justice.

Robert Bovard appeals from the judgment dismissing his supplemental complaint against defendants, American Horse Enterprises, Inc., and James T. Ralph. Bovard contends the trial court erroneously concluded the contract upon which his action was founded was illegal and void as contrary to public policy; alternatively, he contends it is the law of the case that the contract does not violate public policy.... We shall affirm the judgment

I.

[In 1978, James Ralph agreed to purchase American Horse Enterprises, Inc. from Robert Bovard. Ralph executed several promissory notes concerning that purchase, which he failed to honor. Bovard sued.]

[At trial] Bovard testified as to the nature of the business conducted by American Horse Enterprises, Inc., at the time the corporation was sold to Ralph. Bovard explained the corporation made jewelry and drug paraphernalia, which consisted of “roach clips” and “bongs” used to smoke marijuana and tobacco. At that point the trial court excused the jury and asked counsel to prepare arguments on the question whether the contract for sale of the corporation was illegal and void.

The following day, after considering the arguments of counsel, the trial court dismissed the [] complaint. The court found that the corporation predominantly produced paraphernalia used to smoke marijuana and was not engaged significantly in jewelry production, and that Bovard had recovered the corporate machinery through self-help. The parties do not challenge these findings. The court acknowledged that the manufacture of drug paraphernalia was not itself illegal in 1978 when Bovard and Ralph contracted for the sale of American Horse Enterprises, Inc. However, the court concluded a public policy against the manufacture of drug paraphernalia was implicit in the statute making the possession, use and transfer of marijuana unlawful.² The trial court held the consideration for the contract was contrary to the policy of express law, and the contract was therefore illegal and void. Finally, the court found the parties were in *pari delicto* and thus with respect to their contractual dispute should be left as the court found them.

II

The trial court concluded the consideration for the contract was contrary to the policy of the law as expressed in the statute prohibiting the possession, use and transfer of marijuana. Whether a contract is contrary to public policy is a question of law to be determined from the circumstances of the particular case. Here, the critical facts are not in dispute. Whenever a court becomes aware that a contract is illegal, it has a duty to refrain from entertaining an action to enforce the contract. Furthermore the court will not permit the parties to maintain an action to settle or compromise a claim based on an illegal contract.

² The manufacture of drug paraphernalia, including bongs and roach clips, was made criminal effective January 1, 1983.

The question whether a contract violates public policy necessarily involves a degree of subjectivity. Therefore, "... courts have been cautious in blithely applying public policy reasons to nullify otherwise enforceable contracts. This concern has been graphically articulated by the California Supreme Court as follows: "It has been well said that public policy is an unruly horse, astride of which you are carried into unknown and uncertain paths, ... While contracts opposed to morality or law should not be allowed to show themselves in courts of justice, yet public policy requires and encourages the making of contracts by competent parties upon all valid and lawful considerations, and courts so recognizing have allowed parties the widest latitude in this regard; and, unless it is entirely plain that a contract is violative of sound public policy, a court will never so declare." "The power of the courts to declare a contract void for being in contravention of sound public policy is a very delicate and undefined power, and, like the power to declare a statute unconstitutional, should be exercised only in cases free from doubt." "No court ought to refuse its aid to enforce a contract on doubtful and uncertain grounds. The burden is on the defendant to show that its enforcement would be in violation of the settled public policy of this state, or injurious to the morals of its people." (*Moran v. Harris* (1982) 131 Cal.App.3d 913, 919–920, quoting *Stephens v. Southern Pacific Co.* (1895) 109 Cal. 86, 89–90.)

Bovard places great reliance on *Moran v. Harris*, *supra*, to support his argument the trial court erred in finding the contract violative of public policy. In *Moran*, two lawyers entered into a fee splitting agreement relative to a case referred by one to the other. The agreement was made in 1972, ten months before the adoption of a rule of professional conduct prohibiting such agreements. In 1975, the attorney to whom the case had been referred settled the case, but then refused to split the attorney's fees with the referring attorney. The trial court held the fee splitting contract violated public policy. The appellate court reversed, noting the rule of professional conduct had been amended effective January 1, 1979, to permit fee splitting agreements; thus there was no statute or rule prohibiting fee splitting agreements either at the time the attorneys' contract was formed or after January 1, 1979, during the pendency of the action to enforce the fee splitting contract. Therefore, the court held there was no basis for a finding that the contract violated public policy.

Here, in contrast to *Moran*, there is positive law on which to premise a finding of public policy, although the trial court did not find the manufacture of marijuana paraphernalia against public policy on the basis of the later enacted ordinance or statute prohibiting such manufacture.

Rather, the court's finding was based on a statute prohibiting the possession, use and transfer of marijuana which long antedated the parties' contract.³

Moran suggests factors to consider in analyzing whether a contract violates public policy: "Before labeling a contract as being contrary to public policy, courts must carefully inquire into the nature of the conduct, the extent of public harm which may be involved, and the moral quality of the conduct of the parties in light of the prevailing standards of the community."

These factors are more comprehensively set out in the Restatement Second of Contracts section 178:

- (1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.
- (2) In weighing the interest in the enforcement of a term, account is taken of
 - (a) the parties' justified expectations,
 - (b) any forfeiture that would result if enforcement were denied, and
 - (c) any special public interest in the enforcement of the particular term.
- (3) In weighing a public policy against enforcement of a term, account is taken of
 - (a) the strength of that policy as manifested by legislation or judicial decisions,
 - (b) the likelihood that a refusal to enforce the term will further that policy,
 - (c) the seriousness of any misconduct involved and the extent to which it was deliberate, and
 - (d) the directness of the connection between that misconduct and the term.

Applying the Restatement test to the present circumstances, we conclude the interest in enforcing this contract is very tenuous. Neither party was reasonably justified in expecting the

³ "In determining whether the subject of a given contract violates public policy, courts must rely on the state of the law as it existed at the time the contract was made." *Moran v. Harris*.

government would not eventually act to geld American Horse Enterprises, a business harnessed to the production of paraphernalia used to facilitate the use of an illegal drug. Moreover, although avoidance of the contract imposed a forfeiture on Bovard, he did recover the corporate machinery, the only assets of the business which could be used for lawful purposes, i.e., to manufacture jewelry. Thus, the forfeiture was significantly mitigated if not negligible. Finally, there is no special public interest in the enforcement of this contract, only the general interest in preventing a party to a contract from avoiding a debt.

On the other hand, the Restatement factors favoring a public policy against enforcement of this contract are very strong. As we have explained, the public policy against manufacturing paraphernalia to facilitate the use of marijuana is strongly implied in the statutory prohibition against the possession, use, etc., of marijuana, a prohibition which dates back at least to 1929. Obviously, refusal to enforce the instant contract will further that public policy not only in the present circumstances but by serving notice on manufacturers of drug paraphernalia that they may not resort to the judicial system to protect or advance their business interests. Moreover, it is immaterial that the business conducted by American Horse Enterprises was not expressly prohibited by law when Bovard and Ralph made their agreement since both parties knew that the corporation's products would be used primarily for purposes which were expressly illegal. We conclude the trial court correctly declared the contract contrary to the policy of express law and therefore illegal and void.

EVANS and SIMS, JJ., concur.

Notes and Questions

1. Like many other courts, the court in Bovard refers to public policy doctrine as “an unruly horse.” Do you understand why? Is it more “unruly” than other contract law doctrines, especially other formation defenses such as unconscionability or misrepresentation? Why or why not?
2. In an omitted part of the opinion, the court found that because the parties were in *pari delicto* (in equal fault), they would be left as the court found them, and no remedy would be available. Indeed, the doctrine means that when parties are of equal fault, the defendant wins, and the case is dismissed (the full Latin phrase is *in pari delicto potior est conditio defendantis*, which translates to “in equal fault, the condition of the defendant is stronger.”). What can be the rationale for such a rule? Is it fair?

3. Restitution can mitigate the effect of the *in pari delicto* doctrine. The Restatement explains that in exceptional cases, even if both parties are of equal fault, the plaintiff can nevertheless obtain restitution if a party “would otherwise suffer a forfeiture that is disproportionate in relation to the contravention of public policy involved.” Restatement (Second) of Contracts § 197 cmt. b. Do you think that Bovard should have been entitled to restitution?
4. At the time of writing, in 2025, the Bovard decision seems a little archaic, right? What may be outdated is not contract law but the public policy underlying a decision such as Bovard, which seems to be in tension with modern trends concerning marijuana regulation. As we shall see, Bovard is not unusual in this respect, and the public policies used to deny contract enforceability often change rapidly. Should that affect the scope of the public policy doctrine itself?

Watts v. Watts

137 Wis.2d 506, 405 N.W.2d 303 (Supreme Court of Wisconsin, 1987)

ABRAHAMSON, Justice.

The case involves a dispute between Sue Ann Evans Watts, the plaintiff, and James Watts, the defendant, over their respective interests in property accumulated during their nonmarital cohabitation relationship which spanned 12 years and produced two children. The case presents an issue of first impression and comes to this court at the pleading stage of the case, before trial and before the facts have been determined.

The plaintiff asked the circuit court to order an accounting of the defendant’s personal and business assets accumulated between June 1969 through December 1981 (the duration of the parties’ cohabitation) and to determine plaintiff’s share of this property. The circuit court’s dismissal of plaintiff’s amended complaint is the subject of this appeal. The plaintiff rests her claim for an accounting and a share in the accumulated property on the following legal theories: (1) she is entitled to an equitable division of property under sec. 767.255, Stats. 1985–86; (2) the defendant is estopped to assert as a defense to plaintiff’s claim under sec. 767.255, that the parties are not married; (3) the plaintiff is entitled to damages for defendant’s breach of an express contract or an implied-in-fact contract between the parties; (4) the defendant holds the accumulated property under a constructive trust based upon unjust enrichment; and (5) the plaintiff is entitled to partition of the parties’ real and personal property pursuant to

the partition statutes, secs. 820.01 and 842.02(1), 1985–86, and common law principles of partition.

The circuit court dismissed the amended complaint, concluding that sec. 767.255, Stats. 1985–86, authorizing a court to divide property, does not apply to the division of property between unmarried persons. Without analyzing the four other legal theories upon which the plaintiff rests her claim, the circuit court simply concluded that the legislature, not the court, should provide relief to parties who have accumulated property in nonmarital cohabitation relationships. The circuit court gave no further explanation for its decision.

We agree with the circuit court that the legislature did not intend sec. 767.255 to apply to an unmarried couple. We disagree with the circuit court’s implicit conclusion that courts cannot or should not, without express authorization from the legislature, divide property between persons who have engaged in nonmarital cohabitation. Courts traditionally have settled contract and property disputes between unmarried persons, some of whom have cohabited. Nonmarital cohabitation does not render every agreement between the cohabiting parties illegal and does not automatically preclude one of the parties from seeking judicial relief, such as statutory or common law partition, damages for breach of express or implied contract, constructive trust and quantum meruit where the party alleges, and later proves, facts supporting the legal theory. The issue for the court in each case is whether the complaining party has set forth any legally cognizable claim....

I.

The plaintiff commenced this action in 1982. The plaintiff’s amended complaint alleges the following facts, which for purposes of this appeal must be accepted as true. The plaintiff and the defendant met in 1967, when she was 19 years old, was living with her parents and was working full time as a nurse’s aide in preparation for a nursing career. Shortly after the parties met, the defendant persuaded the plaintiff to move into an apartment paid for by him and to quit her job. According to the amended complaint, the defendant “indicated” to the plaintiff that he would provide for her.

Early in 1969, the parties began living together in a “marriage-like” relationship, holding themselves out to the public as husband and wife. The plaintiff assumed the defendant’s surname as her own. Subsequently, she gave birth to two children who were also given the defendant’s surname. The parties filed joint income tax returns and maintained joint bank accounts asserting that they were husband and wife. The defendant insured the plaintiff as his wife on his medical insurance policy. He also took out a life insurance policy on her as his wife, naming himself as the beneficiary. The parties purchased real and personal property as

husband and wife. The plaintiff executed documents and obligated herself on promissory notes to lending institutions as the defendant's wife.

During their relationship, the plaintiff contributed childcare and homemaking services, including cleaning, cooking, laundering, shopping, running errands, and maintaining the grounds surrounding the parties' home. Additionally, the plaintiff contributed personal property to the relationship which she owned at the beginning of the relationship or acquired through gifts or purchases during the relationship. She served as hostess for the defendant for social and business-related events. The amended complaint further asserts that periodically, between 1969 and 1975, the plaintiff cooked and cleaned for the defendant and his employees while his business, a landscaping service, was building and landscaping a golf course.

From 1973 to 1976, the plaintiff worked 20–25 hours per week at the defendant's office, performing duties as a receptionist, typist, and assistant bookkeeper. From 1976 to 1981, the plaintiff worked 40–60 hours per week at a business she started with the defendant's sister-in-law, then continued and managed the business herself after the dissolution of that partnership. The plaintiff further alleges that in 1981 the defendant made their relationship so intolerable that she was forced to move from their home and their relationship was irretrievably broken. Subsequently, the defendant barred the plaintiff from returning to her business.

The plaintiff alleges that during the parties' relationship, and because of her domestic and business contributions, the business and personal wealth of the couple increased. Furthermore, the plaintiff alleges that she never received any compensation for these contributions to the relationship and that the defendant indicated to the plaintiff both orally and through his conduct that he considered her to be his wife and that she would share equally in the increased wealth.

The plaintiff asserts that since the breakdown of the relationship the defendant has refused to share equally with her the wealth accumulated through their joint efforts or to compensate her in any way for her contributions to the relationship.

[The court rejects the plaintiff's claim (i) for division on the property based on the Wisconsin Family Code, holding that it does not apply to unmarried cohabitants; (ii) to hold the defendant estopped from arguing that the couple were not married.]

IV.

The plaintiff's third legal theory on which her claim rests is that she and the defendant had a contract to share equally the property accumulated during their relationship. The essence of

the complaint is that the parties had a contract, either an express or implied in fact contract, which the defendant breached.

Wisconsin courts have long recognized the importance of freedom of contract and have endeavored to protect the right to contract. A contract will not be enforced, however, if it violates public policy. A declaration that the contract is against public policy should be made only after a careful balancing, in the light of all the circumstances, of the interest in enforcing a particular promise against the policy against enforcement. Courts should be reluctant to frustrate a party's reasonable expectations without a corresponding benefit to be gained in deterring "misconduct" or avoiding inappropriate use of the judicial system.

The defendant appears to attack the plaintiff's contract theory on three grounds. First, the defendant apparently asserts that the court's recognition of plaintiff's contract claim for a share of the parties' property contravenes the Wisconsin Family Code. Second, the defendant asserts that the legislature, not the courts, should determine the property and contract rights of unmarried cohabiting parties. Third, the defendant intimates that the parties' relationship was immoral and illegal and that any recognition of a contract between the parties or plaintiff's claim for a share of the property accumulated during the cohabitation contravenes public policy.

The defendant rests his argument that judicial recognition of a contract between unmarried cohabitants for property division violates the Wisconsin Family Code on *Hewitt v. Hewitt* (1979). In *Hewitt* the Illinois Supreme Court concluded that judicial recognition of mutual property rights between unmarried cohabitants would violate the policy of the Illinois Marriage and Dissolution Act because enhancing the attractiveness of a private arrangement contravenes the Act's policy of strengthening and preserving the integrity of marriage. The Illinois court concluded that allowing such a contract claim would weaken the sanctity of marriage, put in doubt the rights of inheritance, and open the door to false pretenses of marriage.

We agree with [those saying] that the *Hewitt* court made an unsupportable inferential leap when it found that cohabitation agreements run contrary to statutory policy and that the *Hewitt* court's approach is patently inconsistent with the principle that public policy limits are to be narrowly and exactly applied.

Furthermore, the Illinois statutes upon which the Illinois supreme court rested its decision are distinguishable from the Wisconsin statutes. The Illinois supreme court relied on the fact that Illinois still retained "fault" divorce and that cohabitation was unlawful. By contrast, Wisconsin

abolished “fault” in divorce in 1977 and abolished criminal sanctions for nonmarital cohabitation in 1983.

The defendant has failed to persuade this court that enforcing an express or implied in fact contract between these parties would in fact violate the Wisconsin Family Code. The Family Code is intended to promote the institution of marriage and the family. We find no indication, however, that the Wisconsin legislature intended the Family Code to restrict in any way a court’s resolution of property or contract disputes between unmarried cohabitants.

The defendant also urges that if the court is not willing to say that the Family Code proscribes contracts between unmarried cohabiting parties, then the court should refuse to resolve the contract and property rights of unmarried cohabitants without legislative guidance. The defendant asserts that this court should conclude, as the *Hewitt* court did, that the task of determining the rights of cohabiting parties is too complex and difficult for the court and should be left to the legislature. We are not persuaded by the defendant’s argument. Courts have traditionally developed principles of contract and property law through the case-by-case method of the common law. While ultimately the legislature may resolve the problems raised by unmarried cohabiting parties, we are not persuaded that the court should refrain from resolving such disputes until the legislature gives us direction. Our survey of the cases in other jurisdictions reveals that *Hewitt* is not widely followed.

We turn to the defendant’s third point, namely, that any contract between the parties regarding property division contravenes public policy because the contract is based on immoral or illegal sexual activity. The defendant does not appear to make this argument directly. It is not well developed in the brief, and at oral argument defendant’s attorney indicated that he did not find this argument persuasive in light of the current community mores, the substantial number of unmarried people who cohabit, and the legislature’s abolition of criminal sanctions for cohabitation. Although the parties in the instant case cohabited at a time when cohabitation was illegal, the defendant’s counsel at oral argument thought that the present law should govern this aspect of the case. Because illegal sexual activity has posed a problem for courts in contract actions, we discuss this issue even though the defendant did not emphasize it.

Courts have generally refused to enforce contracts for which the sole consideration is sexual relations, sometimes referred to as “meretricious” relationships. Courts distinguish, however, between contracts that are explicitly and inseparably founded on sexual services and those that are not. This court, and numerous other courts, have concluded that “a bargain between two people is not illegal merely because there is an illicit relationship between the two so long as

the bargain is independent of the illicit relationship and the illicit relationship does not constitute any part of the consideration bargained for and is not a condition of the bargain.”

While not condoning the illicit sexual relationship of the parties, many courts have recognized that the result of a court’s refusal to enforce contract and property rights between unmarried cohabitants is that one party keeps all or most of the assets accumulated during the relationship, while the other party, no more or less “guilty,” is deprived of property which he or she has helped to accumulate.

The *Hewitt* decision, which leaves one party to the relationship enriched at the expense of the other party who had contributed to the acquisition of the property, has often been criticized by courts and commentators as being unduly harsh. Moreover, courts recognize that their refusal to enforce what are in other contexts clearly lawful promises will not undo the parties’ relationship and may not discourage others from entering into such relationships. A harsh, *per se* rule that the contract and property rights of unmarried cohabiting parties will not be recognized might actually encourage a partner with greater income potential to avoid marriage in order to retain all accumulated assets, leaving the other party with nothing....

Having reviewed the complaint and surveyed the law in this and other jurisdictions, we hold that the Family Code does not preclude an unmarried cohabitant from asserting contract and property claims against the other party to the cohabitation. We further conclude that public policy does not necessarily preclude an unmarried cohabitant from asserting a contract claim against the other party to the cohabitation so long as the claim exists independently of the sexual relationship and is supported by separate consideration. Accordingly, we conclude that the plaintiff in this case has pleaded the facts necessary to state a claim for damages resulting from the defendant’s breach of an express or an implied in fact contract to share with the plaintiff the property accumulated through the efforts of both parties during their relationship. Once again, we do not judge the merits of the plaintiff’s claim; we merely hold that she be given her day in court to prove her claim.

[The court also allows the plaintiff claim for unjust enrichment to proceed. The plaintiff “alleges that the defendant accepted and retained the benefit of services she provided knowing that she expected to share equally in the wealth accumulated during their relationship. She argues that it is unfair for the defendant to retain all the assets they accumulated under these circumstances and that a constructive trust should be imposed on the property as a result of the defendant’s unjust enrichment.” The court accepts this claim in principle holding that “allowing no relief at all to one party in a so-called ‘illicit’ relationship effectively provides total relief to the other, by leaving that party owner of all the assets acquired through the efforts of

both. Yet it cannot seriously be argued that the party retaining all the assets is less 'guilty' than the other. Such a result is contrary to the principles of equity. Many courts have held, and we now so hold, that unmarried cohabitants may raise claims based upon unjust enrichment following the termination of their relationships where one of the parties attempts to retain an unreasonable amount of the property acquired through the efforts of both.

The court also allows the plaintiff to base her claim on the property law's doctrine of partition.]

The judgment of the circuit court is reversed and the cause remanded.

Notes and Questions

1. At least in the past, it was a state interest to encourage couples to get married. Assuming, arguably, that it is still the state's interest, does this decision undermine it? And if so, do you agree with it?
2. As in *Bovard*, in *Watts*, the court also dealt with fast-changing underlying social reality. As the court noted, including in an omitted part of its opinion, this is not an outlier, and at the time, courts throughout the country delivered opinions regarding the enforceability of contracts between unmarried cohabitants.
3. Family relations are one of the primary contexts in which courts are willing to balance the freedom of contracts against general public policies. The famous case of Baby M is one such famous matter. Mary Beth Whitehead agreed to be a surrogate mother for William and Elizabeth Stern, using William's sperm and her egg. After giving birth, Whitehead decided to keep the baby instead of giving her to the Sterns as planned. The New Jersey Supreme Court ultimately ruled that surrogacy contracts for the exchange of money were invalid but awarded custody of the child to William Stern, recognizing his parental rights. Mary Beth Whitehead was granted visitation rights, highlighting the complex ethical and legal issues surrounding surrogacy. *In re Baby M*, 109 N.J. 396, 537 A.2d 1227 (1988). Surrogacy contracts are much more common these days and are typically enforced, although regulated, in many states.

Another line of family-related cases has to do with frozen embryos. Assume that a couple agrees to have frozen embryos under a contract that determines the fate of those embryos if the parties break up prior to pregnancy. Are those contracts enforceable? Most courts dealing with this issue say they are. Here is the reasoning of one such famous opinion:

[P]arties should be encouraged in advance, before embarking on [in vitro fertilization] and cryopreservation, to think through possible contingencies and carefully specify their wishes in writing. Explicit agreements avoid costly litigation in business transactions. They are all the more necessary and desirable in personal matters of reproductive choice, where the intangible costs of any litigation are simply incalculable. Advance directives, subject to mutual change of mind that must be jointly expressed, both minimize misunderstandings and maximize procreative liberty by reserving to the progenitors the authority to make what is in the first instance a quintessentially personal, private decision. Written agreements also provide the certainty needed for effective operation of [in vitro fertilization] programs.

To the extent possible, it should be the progenitors—not the State and not the courts—who by their prior directive make this deeply personal life choice.

Kass v. Kass, 91 N.Y.2d 554, 673 (1998).

But a minority of courts disagree, holding that this is the prerogative of the courts to balance the parties' interest at the time of the dispute (or, at least in one jurisdiction, Iowa, to prevent pregnancy altogether unless both parties agree to it). As one famous decision put it:

[E]ven had the husband and the wife entered into an unambiguous agreement between themselves regarding the disposition of the frozen preembryos, we would not enforce an agreement that would compel one donor to become a parent against his or her will. As a matter of public policy, we conclude that forced procreation is not an area amenable to judicial enforcement.

A.Z. v. B.Z., 431 Mass. 150 (2000).

Which approach do you find more convincing? You can consider arguments concerning freedom of contract, foreseeability, power dynamics, information costs, privacy, the best interests of children, and more.

Hopper v. All Pet Animal Clinic, Inc.

861 P.2d 531 (Supreme Court of Wyoming, 1993)

TAYLOR, Justice.

These consolidated appeals test the enforceability of a covenant not to compete which was included in an employment contract. The district court found that the covenant imposed reasonable geographic and durational limits necessary to protect the employers' businesses and enjoined a veterinarian from practicing small animal medicine for three years within a five mile radius of the city limits of Laramie, Wyoming. The district court denied a damage claim for breach of the employment agreement brought by the veterinarian's two corporate employers because it was speculative. The veterinarian appeals from the decision to enforce the terms of the covenant. In the companion case, the corporate employers appeal the decision to deny damages.

We hold that the covenant's three year duration imposed an unreasonable restraint of trade permitting only partial enforcement of a portion of that term of the covenant. We affirm the district court's conclusions of law that the remaining terms of the covenant were reasonable. We also affirm the district court's judgment refusing damages because the finding that damages were unproven is not clearly erroneous.

II. FACTS

Following her graduation from Colorado State University, Dr. Glenna Hopper (Dr. Hopper) began working part-time as a veterinarian at the All Pet Animal Clinic, Inc. (All Pet) in July of 1988. All Pet specialized in the care of small animals; mostly domesticated dogs and cats, and those exotic animals maintained as household pets. Dr. Hopper practiced under the guidance and direction of the President of All Pet, Dr. Robert Bruce Johnson (Dr. Johnson).

Dr. Johnson, on behalf of All Pet, offered Dr. Hopper full-time employment in February of 1989. The oral offer included a specified salary and potential for bonus earnings as well as other terms of employment. According to Dr. Johnson, he conditioned the offer on Dr. Hopper's acceptance of a covenant not to compete, the specific details of which were not discussed at the time. Dr. Hopper commenced full-time employment with All Pet under the oral agreement in March of 1989 and relocated to Laramie, discontinuing her commute from her former residence in Colorado.

A written Employment Agreement incorporating the terms of the oral agreement was finally executed by the parties on December 11, 1989. Ancillary to the provisions for employment, the agreement detailed the terms of a covenant not to compete:

12. This agreement may be terminated by either party upon 30 days' notice to the other party. Upon termination, Dr. Hopper agrees that she will not practice small animal medicine for a period of three years from the date of termination within 5 miles of the corporate limits of the City of Laramie, Wyoming. Dr. Hopper agrees that the duration and geographic scope of that limitation is reasonable.

The agreement was antedated to be effective to March 3, 1989.

One year later, reacting to a rumor that Dr. Hopper was investigating the purchase of a veterinary practice in Laramie, Dr. Johnson asked his attorney to prepare a letter which was presented to Dr. Hopper. The letter, dated June 17, 1991, stated:

I have learned that you are considering leaving us to take over the small animal part of Dr. Meeboer's practice in Laramie.

When we negotiated the terms of your employment, we agreed that you could leave upon 30 days' notice, but that you would not practice small animal medicine within five miles of Laramie for a three-year period. We do not have any non-competition agreement for large-animal medicine, which therefore does not enter into the picture.

I am willing to release you from the non-competition agreement in return for a cash buy-out. I have worked back from the proportion of the income of All-Pet and Alpine which you contribute and have decided that a reasonable figure would be \$40,000.00, to compensate the practice for the loss of business which will happen if you practice small-animal medicine elsewhere in Laramie.

If you are willing to approach the problem in the way I suggest, please let me know and I will have the appropriate paperwork taken care of.

Sincerely,

[Signed]

R. Bruce Johnson,

D.V.M.

Dr. Hopper responded to the letter by denying that she was going to purchase Dr. Meeboer's practice. Dr. Hopper told Dr. Johnson that the Employment Agreement was not worth the paper it was written on and that she could do anything she wanted to do. Dr. Johnson

terminated Dr. Hopper's employment and informed her to consider the 30-day notice as having been given. An unsigned, handwritten note from Dr. Johnson to Dr. Hopper, dated June 18, 1991, affirmed the termination and notice providing, in part:

Per your request to abide by your employment agreement with All Pet and Alpine as regards termination:

Be advised that your last day of employment is July 18, 1991 for reasons that we are both aware of and have discussed previously.

Subsequently, Dr. Hopper purchased Gem City Veterinary Clinic (Gem City), the practice of Dr. Melanie Manning. Beginning on July 15, 1991, Dr. Hopper operated Gem City, in violation of the covenant not to compete, within the City of Laramie and with a practice including large and small animals. Under Dr. Hopper's guidance, Gem City's client list grew from 368 at the time she purchased the practice to approximately 950 at the time of trial. A comparison of client lists disclosed that 187 clients served by Dr. Hopper at Gem City were also clients of All Pet or Alpine. Some of these shared clients received permissible large animal services from Dr. Hopper. Overall, the small animal work contributed from fifty-one to fifty-two percent of Dr. Hopper's gross income at Gem City.

All Pet and Alpine filed a complaint against Dr. Hopper on November 15, 1991 seeking injunctive relief and damages for breach of the covenant not to compete contained in the Employment Agreement. Notably, All Pet and Alpine did not seek a temporary injunction to restrict Dr. Hopper's practice and possibly mitigate damages during the pendency of the proceeding. Trial was conducted on September 28, 1992.

The district court, in its Findings of Fact, Conclusions of Law and Judgment, determined that the covenant not to compete was enforceable as a matter of law and contained reasonable durational and geographic limits necessary to protect All Pet's and Alpine's special interests. The special interests found by the district court included: special influence over and direct contact with All Pet's and Alpine's clients; access to client files; access to pricing policies; and instruction in practice development. Dr. Hopper was enjoined from practicing small animal medicine within five miles of the corporate limits of the City of Laramie for a period of three years from July 18, 1991. The district court found that the amount of damages suffered by All Pet and Alpine was speculative and not proven by a preponderance of the evidence....

IV. DISCUSSION

A. The Enforceability of a Covenant Not to Compete

The common law policy against contracts in restraint of trade is one of the oldest and most firmly established. Restatement (Second) of Contracts §§ 185–188 (1981) (Introductory Note at 35). The traditional disfavor of such restraints means covenants not to compete are construed against the party seeking to enforce them. The initial burden is on the employer to prove the covenant is reasonable and has a fair relation to, and is necessary for, the business interests for which protection is sought.

Two principles, the freedom to contract and the freedom to work, conflict when courts test the enforceability of covenants not to compete. There is general recognition that while an employer may seek protection from improper and unfair competition of a former employee, the employer is not entitled to protection against ordinary competition. The enforceability of a covenant not to compete depends upon a finding that the proper balance exists between the competing interests of the employer and the employee. *See* Restatement (Second) of Agency § 393 cmt. e (1958) (noting that without a covenant not to compete, an agent, employee, can compete with a principal despite past employment and can begin preparations for future competition, such as purchasing a competitive business, before leaving present employment).

Wyoming adopted a rule of reason inquiry from the Restatement of Contracts testing the validity of a covenant not to compete. The present formulation of the rule of reason is contained in Restatement (Second) of Contracts, *supra*, § 188:

- (1) A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade if
 - (a) the restraint is greater than is needed to protect the promisee's legitimate interest, or
 - (b) the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public.
- (2) Promises imposing restraints that are ancillary to a valid transaction or relationship include the following:
 - (a) a promise by the seller of a business not to compete with the buyer in such a way as to injure the value of the business sold;
 - (b) a promise by an employee or other agent not to compete with his employer or other principal;
 - (c) a promise by a partner not to compete with the partnership.

See also Restatement (Second) of Contracts, *supra*, §§ 186–187. An often quoted reformulation of the rule of reason inquiry states that “[a] restraint is reasonable only if it (1) is no greater than is required for the protection of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public.” Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv.L.Rev. 625, 648–49 (1960).

A valid and enforceable covenant not to compete requires a showing that the covenant is: (1) in writing; (2) part of a contract of employment; (3) based on reasonable consideration; (4) reasonable in durational and geographical limitations; and (5) not against public policy. The reasonableness of a covenant not to compete is assessed based upon the facts of the particular case and a review of all of the circumstances.

While many factors may be considered by the court in evaluating reasonableness as a matter of law, a useful enumeration is contained in *Philip G. Johnson & Co. v. Salmen*, 211 Neb. 123 (1982):

The considerations to be balanced are the degree of inequality in bargaining power; the risk of the covenantee losing customers; the extent of respective participation by the parties in securing and retaining customers; the good faith of the covenantee; the existence of sources or general knowledge pertaining to the identity of customers; the nature and extent of the business position held by the covenantor; the covenantor’s training, health, education, and needs of his family; the current conditions of employment; the necessity of the covenantor changing his calling or residence; and the correspondence of the restraint with the need for protecting the legitimate interests of the covenantee.

Wyoming has previously recognized that the legitimate interests of the employer, covenantee, which may be protected from competition include: (a) the employer’s trade secrets which have been communicated to the employee during the course of employment; (b) confidential information communicated by the employer to the employee, but not involving trade secrets, such as information on a unique business method; and (c) special influence by the employee obtained during the course of employment over the employer’s customers....

The written Employment Agreement Dr. Hopper signed contains no evidence of separate consideration, such as a pay raise or other benefit, in exchange for the covenant not to compete. Standing alone, the covenant not to compete contained in the Employment Agreement failed due to lack of separate consideration. Restatement (Second) of Contracts, *supra*, § 187. However, on June 1, 1990, the parties executed the Addendum to Agreement. In

that agreement, Dr. Hopper accepted a pay raise of \$550.00 per month. This agreement restates, by incorporation, the terms of the covenant not to compete. We hold that the Addendum to Agreement, with its pay raise, represented sufficient separate consideration supporting the reaffirmation of the covenant not to compete. Therefore, the district court's findings that the covenant was ancillary to an employment contract and that consideration was received in exchange for the covenant are not clearly erroneous.

The contract permitted either Dr. Hopper or her corporate employers to terminate her employment with notice. The agreement did not state a length of employment and it permitted termination at will. Without more, the terms present the potential for an unreasonable restraint of trade. For example, if an employer hired an employee at will, obtained a covenant not to compete, and then terminated the employee, without cause, to arbitrarily restrict competition, we believe such conduct would constitute bad faith. Simple justice requires that a termination by the employer of an at will employee be in good faith if a covenant not to compete is to be enforced.

Under the present facts, we cannot say that the termination of Dr. Hopper occurred in bad faith. Trial testimony presented evidence of increasing tension prior to termination in the professional relationship between Dr. Johnson and Dr. Hopper. This tension, however, did not appear to result in the termination. The notice of termination was given after Dr. Hopper was confronted about her negotiations to purchase a competitive practice and after Dr. Hopper had termed the employment contract worthless. We cannot find in these facts a bad faith termination which would provide a reason to depart from the district court's finding that the contract of employment was valid. With the determination that as a matter of law the covenant is ancillary to a valid employment relationship, we turn to the rule of reason inquiry.

Employers are entitled to protect their business from the detrimental impact of competition by employees who, but for their employment, would not have had the ability to gain a special influence over clients or customers. *Beckman v. Cox Broadcasting Corp.*, 250 Ga. 127, 296 S.E.2d 566 (1982) illustrates the principle in the broadcast industry where the clients are the viewers of a particular station. Beckman was a television weather forecaster whose contributions to the "Action News Team" had been extensively promoted by Cox during his employment. The promotion and Beckman's personality succeeded in attracting viewers to watch the television station. When his contract with Cox expired, Beckman accepted employment with a competitive television station in the same city and sought a declaratory judgment to determine the validity of a restrictive covenant which prevented him from appearing on television for six months within a radius of thirty-five miles of Cox's station offices.

The Supreme Court of Georgia agreed that Beckman was entitled to take to a new employer his assets as an employee which he had contributed to his former employer. “It is true that an employee’s aptitude, skill, dexterity, manual and mental ability and other subjective knowledge obtained in the course of employment are not property of the employer which the employer can, in absence of a contractual right, prohibit the employee from taking with him at the termination of employment.” *Id.* The covenant permitted Cox to recover from the loss of Beckman’s services by implementing a transition plan while still permitting Beckman to work as a meteorologist, but not to the extent of appearing on air with a competitive television station. The *Beckman* court determined that the business interests of Cox required protection which enforcement of the reasonable terms of the covenant provided.

The special interests of All Pet and Alpine identified by the district court as findings of fact are not clearly erroneous. Dr. Hopper moved to Laramie upon completion of her degree prior to any significant professional contact with the community. Her introduction to All Pet’s and Alpine’s clients, client files, pricing policies, and practice development techniques provided information which exceeded the skills she brought to her employment. While she was a licensed and trained veterinarian when she accepted employment, the additional exposure to clients and knowledge of clinic operations her employers shared with her had a monetary value for which the employers are entitled to reasonable protection from irreparable harm. The proven loss of 187 of All Pet’s and Alpine’s clients to Dr. Hopper’s new practice sufficiently demonstrated actual harm from unfair competition.

The reasonableness, in a given fact situation, of the limitations placed on a former employee by a covenant not to compete are determinations made by the court as a matter of law. Therefore, the district court’s conclusions of law about the reasonableness of the type of activity, geographic, and durational limits contained in the covenant are subject to *de novo* review.

All parties to this litigation devoted extensive research to evaluations of the reasonableness of various covenants not to compete from different authorities. However, we find precedent from our own or from other jurisdictions to be of limited value in considering the reasonableness of limits contained in a specific covenant not to compete. For example, in *Cukjati*, 772 S.W.2d at 216, 218, the Court of Appeals of Texas held a covenant not to compete was unreasonable because it limited a veterinarian from practicing within twelve miles of his former employer’s clinic in North Irving, a community within the Dallas–Fort Worth metropolitan area. Because evidence from that proceeding disclosed that Dallas area residents are unlikely to travel more than a few miles for pet care, the court found the restriction unreasonable. The number of veterinarians and the demands upon their services obviously

varies between Laramie, Wyoming and metropolitan Dallas, Texas, creating a different usage pattern. We believe the reasonableness of individual limitations contained in a specific covenant not to compete must be assessed based upon the facts of that proceeding.

Useful legal principles do emerge from a survey of relevant authorities and may certainly be applied to decisions about the reasonableness of the type of activity, geographic, and durational limitations. Testing the reasonableness of the type of activity limitation provides an opportunity for the court to consider the broader public policy implications of a covenant not to compete. The decision of the Court of Appeals of Ohio in *Williams v. Hobbs*, 9 Ohio App.3d 331 (1983) explains. The *Williams* court determined that enforcing a covenant not to compete restricting a radiologist's uncommon specialty practice would violate public policy because the community would be deprived of a unique skill. In addition, the court held the type of activity limitation was unreasonable because it created an undue hardship on the physician where there were only a limited number of osteopathic hospitals available to practice his specialty.

The Court of Appeals of Arkansas, in an en banc opinion, used a similar analysis in reviewing a covenant not to compete which restricted an orthopedic surgeon from practicing medicine within a radius of thirty miles from the offices of his former partners. *Duffner*, 718 S.W.2d at 113–14. The court held that the covenant interfered with the public's right to choose an orthopedic surgeon and that enforcement of the covenant created an unreasonable restraint of trade. In determining that no business interests of the partnership were lost, the court noted that while the surgeon provided normal post-operative care for those patients he had operated on while associated with the partnership, he had not "appropriated" any of the partnership's "stock of patients" when he moved to another office.

Enforcement of the practice restrictions Dr. Hopper accepted as part of her covenant not to compete does not create an unreasonable restraint of trade. While the specific terms of the covenant failed to define the practice of small animal medicine, the parties' trade usage provided a conforming standard of domesticated dogs and cats along with exotic animals maintained as household pets. As a veterinarian licensed to practice in Wyoming, Dr. Hopper was therefore permitted to earn a living in her chosen profession without relocating by practicing large animal medicine, a significant area of practice in this state. The restriction on the type of activity contained in the covenant was sufficiently limited to avoid undue hardship to Dr. Hopper while protecting the special interests of All Pet and Alpine.

In addition, as a professional, Dr. Hopper certainly realized the implications of agreeing to the terms of the covenant. While she may have doubted either her employers' desires to enforce the terms or the legality of the covenant, her actions in establishing a small animal practice

violated the promise she made. In equity, she comes before the court with unclean hands. If Dr. Hopper sought to challenge the enforceability of the covenant, her proper remedy was to seek a declaratory judgment.

The public will not suffer injury from enforcement of the covenant. Dr. Hopper's services at All Pet and Alpine were primarily to provide relief for the full-time veterinarians at those clinics. In addition to dividing her time between the clinics, she covered when others had days off or, on a rotating basis, on weekends. While Dr. Hopper provided competent care to All Pet's and Alpine's clients, her services there were neither unique nor uncommon. Furthermore, the services which Dr. Hopper provided in her new practice to small animal clients were available at several other veterinary clinics within Laramie. Evidence did not challenge the public's ability to receive complete and satisfactory service from these other sources. Dr. Hopper's short term unavailability resulting from enforcement of a reasonable restraint against unfair competition is unlikely, as a matter of law, to produce injury to the public.

Reasonable geographic restraints are generally limited to the area in which the former employee actually worked or from which clients were drawn. When the business serves a limited geographic area, as opposed to statewide or nationwide, courts have upheld geographic limits which are coextensive with the area in which the employer conducts business. A broad geographic restriction may be reasonable when it is coupled with a specific activity restriction within an industry or business which has an inherently limited client base.

The geographical limit contained in the covenant not to compete restricts Dr. Hopper from practicing within a five mile radius of the corporate limits of Laramie. As a matter of law, this limit is reasonable in this circumstance. The evidence presented at trial indicated that the clients of All Pet and Alpine were located throughout the county. Despite Wyoming's rural character, the five mile restriction effectively limited unfair competition without presenting an undue hardship. Dr. Hopper could, for example, have opened a practice at other locations within the county.

A durational limitation should be reasonably related to the legitimate interest which the employer is seeking to protect. Restatement (Second) of Contracts, *supra*, § 188 cmt. b.

In determining whether a restraint extends for a longer period of time than necessary to protect the employer, the court must determine how much time is needed for the risk of injury to be reasonably moderated. When the restraint is for the purpose of protecting customer relationships, its duration is reasonable

only if it is no longer than necessary for the employer to put a new [individual] on the job and for the new employee to have a reasonable opportunity to demonstrate his [or her] effectiveness to the customers. If a restraint on this ground is justifiable at all, it seems that a period of several months would usually be reasonable. If the selling or servicing relationship is relatively complex, a longer period may be called for. Courts seldom criticize restraints of six months or a year on the grounds of duration as such, and even longer restraints are often enforced.

Blake, 73 Harv.L.Rev. at 677.

The evidence at trial focused on the durational requirement in attempting to establish the three year term as being necessary to diffuse the potential loss of clients from All Pet and Alpine to Dr. Hopper. Dr. Charles Sink, a licensed veterinarian, testified as an expert on behalf of All Pet and Alpine and indicated that in Wyoming, his experience correlated with national studies that disclosed about 70% of clients visit a clinic more than once per year. The remaining 30% of the clients use the clinic at least one time per year. Dr. Johnson estimated that at All Pet and Alpine, the average client seeks veterinarian services one and one-half times a year. Apart from this data about average client visits, other support for the three year durational requirement was derived from opinion testimony. Dr. Johnson admitted that influence over a client disappears in an unspecified “short period of time,” but expressed a view that three years was “safe.” He also agreed that the number of clients possibly transferring from All Pet or Alpine to Dr. Hopper would be greatest in the first year and diminish in the second year.

We are unable to find a reasonable relationship between the three year durational requirement and the protection of All Pet’s and Alpine’s special interests. Therefore, enforcement of the entire durational term contained in the covenant not to compete violates public policy as an unreasonable restraint of trade. Restatement (Second) of Contracts, *supra*, § 188. Based on figures of client visits, a replacement veterinarian at All Pet and Alpine would be able to effectively demonstrate his or her own professionalism to virtually all of the clinics’ clients within a one year durational limit. Since no credible evidence was presented supporting the need for multiple visits to establish special influence over clients, a one year limit is sufficient to moderate the risk of injury to All Pet and Alpine from unfair competition by Dr. Hopper.

A one year durational limit sufficiently secures All Pet’s and Alpine’s interests in pricing policies and practice development information. Pricing policies at All Pet and Alpine were changed yearly, according to Dr. Johnson, to reflect changes in material and service costs provided by the clinics as well as new procedures. Practice development information,

especially in a learned profession, loses its value quickly as technological change occurs and new reference material become available. We hold, as a matter of law, that enforcement of a one year durational limit is reasonable and sufficiently protects the interests of All Pet and Alpine without violating public policy....

We, therefore, affirm the district court's conclusions of law that the type of activity and geographic limitations contained in the covenant not to compete were reasonable and enforceable as a matter of law. Because we hold that the covenant's three year durational term imposed a partially unreasonable restraint of trade, we remand for a modification of the judgment to enjoin Dr. Hopper from unfair competition for a duration of one year from the date of termination.

B. Damages for Violation of a Covenant Not to Compete

Wyoming's general rules of damage recovery are well established. "Damages must be proven with a reasonable degree of certainty; however, proof of exact damages is not required." No previous decision of this court has considered the proper measure of damages for a breach of a covenant not to compete which is ancillary to a valid employment contract. However, consistent with our general principles of damage recovery, we accept the view that "[l]ost profits are generally recognized as a proper element of recovery for breach of a covenant not to compete."

All Pet and Alpine presented three approaches to computing a damage figure. The first system considered an average fee charged for veterinarian services at All Pet and Alpine which was multiplied by the number of clients believed lost to Dr. Hopper. The second method considered the amount of profit realized by Dr. Hopper on the services she provided to former clients of All Pet and Alpine. The third approach calculated a loss of profits at All Pet and Alpine from a reduction in the total number of client visits in the year following Dr. Hopper's departure.

All three of All Pet's and Alpine's methods of damage calculation were based on figures for gross profits. In his testimony, Dr. Johnson speculated that his net profits from the lost clients would be ninety percent of the gross. He based this figure on the incredible assumption that his only costs for servicing these clients would be drugs. Dr. Johnson testified that his other fixed costs, including mortgage and receptionist, were paid for by the first clients who come in to the clinics. He assumed that the profit margin from all clients lost to Dr. Hopper would be at a higher rate because the lost clients would be served at the clinics after all fixed costs were paid.

The finding of the district court that the amount of damages suffered was speculative and unproven by a preponderance of the evidence is not clearly erroneous. The ninety percent net profit assumption defies logic and does not represent any attempt to apply common accounting principles, such as prorating of expenses. The necessary costs of doing business, such as costs of drugs dispensed, accounting charges, staff wages and depreciation on the value of equipment, were never established. Calculating the cost and expense of operation is an essential item in the proof of damages in a suit seeking net lost profits for violation of a covenant not to compete. Without these calculations, All Pet's and Alpine's damage claims fail.

V. CONCLUSION

A well-drafted covenant not to compete preserves a careful and necessary economic balance in our society. While there are many layers to the employer-employee relationship, preventing unfair competition from employees who misuse trade secrets or special influence over customers serves public policy. Tempering the balance is the need to protect employees from unfair restraints on competition which defeat broad policy goals in favor of small business and individual advancement. Courts, in reviewing covenants not to compete, must consider these policy implications in assessing the reasonableness of the restraint as it applies to both employer and employee.

Affirmed as modified and remanded for issuance of a judgment in conformity herewith.

CARDINE, Justice, dissenting.

Glenna Hopper has beaten the system. Just prior to being terminated, Dr. Hopper informed Dr. Johnson that "the [covenant] isn't worth the paper it's written on." And she was right. Upon termination, she went into the veterinary business in violation of her covenant not to compete. From July 15, 1991, until October 6, 1992, Dr. Hopper practiced small animal medicine in violation of her solemn promise in her employment agreement not to compete. Whether she continued to practice small animal veterinary medicine after October 6, 1992, in violation of the covenant is not disclosed by the record on appeal.

The court has now decided as a matter of law that a one-year non-competition restriction is reasonable, and a longer period is unreasonable. This pronouncement establishes for the future the period during which competition can be restricted....

I would hold, therefore, that the covenant was supported by consideration from the beginning and was lawful and enforceable, and I would require that appellant be enjoined from that part

of the practice of veterinary medicine specified in the covenant not to compete from the date the trial court, on remand, enters its modified judgment for at least the one-year period which this court now finds reasonable.

Notes and Questions

1. Some promises to restrain trade are per se unenforceable, typically under antitrust law. For example, a promise between competitors to keep prices high — “horizontal price fixing” in antitrust lingo — is illegal (and criminal) under federal law, which would make the contract unenforceable.

However, employment non-compete provisions are more controversial, and state laws vary in dealing with them. Some states, most notably California, do not enforce employment non-compete provisions except in very narrow circumstances prescribed by statute. Most states, however, enforce those provisions provided they are reasonable. Can you identify the benefits and costs of those provisions to the employer, employee, and the public?

Professor Orly Lobel argued that some studies show noncompete clauses suppress both innovation and wages. ORLY LOBEL, *TALENT WANTS TO BE FREE* (2013). For example, one study found that Hawai'i's 2015 ban on noncompete agreements for high-tech workers led to an 11% increase in job mobility (which Lobel argues is an indicator of innovation) and a 4% increase in new-hire salaries.

Another argument made by those who oppose the enforceability of non-compete agreements is that banning them in California benefited businesses that receive “knowledge spillovers” as employees move from firm to firm, bringing with them knowledge acquired at previous jobs. *See* Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, And Covenants Not to Compete*, 74 NYU L. REV. 575 (1999); Orly Lobel, *The New Cognitive Property: Human Capital Law and the Reach of Intellectual Property*, 93 TEX. L. REV. (2014).

Are you convinced? Should non-complete agreement be unenforceable as against public policy? Why and why not?

2. Noncompete provisions typically include restrictions on employment that are limited to a specific type of employment in a certain geographic area for a specified length of

time. Make sure you understand how the *Hopper* court analyzed the reasonableness of each of those elements.

3. The implications of finding a provision unenforceable due to public policy vary by jurisdiction. Some jurisdictions follow the “all or nothing” approach, meaning that if any part of a provision is unenforceable, for example, because a non-complete restriction is too broad or too long, the entire provision is unenforceable. That approach is called for by Restatement (First) of Contracts § 518. Other jurisdictions follow the “blue pencil” approach, which enables the court to enforce the reasonable terms provided the provision remains grammatically coherent once its unreasonable parts are deleted. Finally, some jurisdictions follow the “partial enforcement” (or liberal blue pencil) approach, which reforms and enforces the provision to the extent it is reasonable, unless the circumstances indicate bad faith or deliberate overreaching on the employer’s part. Restatement (Second) of Contracts § 184 supports that approach.

Historically, Wyoming followed the “all or nothing” approach. In an omitted part of *Hopper*, the state Supreme Court adopted the liberal blue pencil approach, holding that an unreasonable three-year restriction would be enforced for one year. However, in 2002, in *Hassler v. Circle Resources*, 505 P.3d 169 (Wy. 2002), the state Supreme Court changed course again, overruled *Hopper*, and (re)adopted the “all or nothing” approach. The Court reasoned that returning to the “all or nothing” approach better supports weaker employees. Do you see why? And more broadly, how will each of these approaches affect the ways that employers draft non-compete provisions?

4. On April 23, 2024, the Federal Trade Commission (FTC) issued a rule banning new non-compete provisions, declaring them “an unfair method of competition” under Section 5 of the Federal Trade Commission Act. Existing non-competes remain enforceable only for “senior executives.” The rule was published on May 7, 2024, and scheduled to take effect 120 days later. However, multiple lawsuits were filed immediately. In July and August 2024, federal judges in Texas and Florida issued preliminary injunctions blocking the rule. Later, a federal judge in Texas held the rule unenforceable because the FTC exceeded its authority and acted arbitrarily and capriciously. The FTC appealed to the Fifth and Eleventh Circuits, but on March 7, 2025, following President Trump’s election, it asked both courts to pause the appeals for 120 days to allow further study. The courts granted those motions.

The main questions those lawsuits raise have less to do with contract law and more to do with principles of administrative law and, more specifically, with the FTC regulatory

authority. At the time of writing (summer 2025), it seems rather unlikely (although technically possible) that this rule will come into effect in the near future