The Sale of a Business--Restraints upon the Vendor's Right to Compete

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the infusion of extraneous passion. The moral health of the community is strengthened by according even the most miserable and pathetic criminal those rights which the Constitution has designed for all. . . .85

If the American free press were to find the disinterest and intelligence to comprehend the significance of these last two short sentences, the need to rehabilitate the dormant and disabled power of contempt would never arise.

FRANK BERNDT

The Sale of a Business—Restraints Upon the Vendor's Right to Compete

This note discusses the express and implied obligations which are legally imposed upon the vendor of a business so as to limit or preclude him from actively competing with the business he has conveyed to the vendee. The underlying justification for permitting restrictions to be placed upon an individual's right to engage in a business of his choice arises from the fact that in the sale of his business he has transferred, and has been compensated for, the goodwill which existed therein. The restrictions placed upon the vendor of the business vary depending on whether he has parted with only the goodwill of his prior business or has also granted to the vendee a covenant not to compete. A transfer of the goodwill of a business grants to the vendee lesser rights than those he acquires from the inclusion of a covenant not to compete in the sales contract.

ACQUIRING THE VENDOR'S GOODWILL

By paying an amount in excess of the value of a firm's tangible property the vendee can acquire the goodwill present in a vendor's business. A going business has a value over and above the aggregate value of the tangible property employed in it. Such excess of value is nothing more than the recognition that, used in an established business that has won the favor of its customers, the tangibles may be expected to earn in the future as they have in the past. The owner's privilege of so using them and his privilege of continuing to deal with customers attracted by the established business, are property of value. This latter privilege is known as goodwill.1

Out of the transfer of the goodwill arise specific restrictions upon the vendor which prohibit him from derogating from the value of the asset he has sold.2 Inasmuch as the sale of goodwill primarily grants to the

vendee the right to attempt to continue favorable customer relations, which the vendor has developed, this right is protected against competitive interference by the vendor. If it were otherwise and the vendor had the unlimited right to re-engage in a competitive business, he could attract his old customers to his new establishment and thereby destroy the value of the property right he has sold. To remove such a possibility the general principle has developed that the sale of a business and its goodwill carries with it an implied obligation that the vendor will do nothing directly to injure the good disposition of the public towards the old business, or impair the advantages and benefits which the vendee has acquired by the purchase of the goodwill. Although sound in theory, this principle has proved to be the source of great difficulty when attempts are made to apply it to particular factual situations.

**Implied Transfer of Goodwill Upon Sale of A Business**

The great majority of courts recognize that a contract for the voluntary sale of a business, either by express statement or by implication from the nature of the agreement, transfers the goodwill along with the tangible assets of the vendor's business. Some courts, going further, have held that the sale of a firm's assets raises a presumption that goodwill has passed. Other courts have declared that goodwill is parasitic in nature.

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1. Haberle Crystal Springs Brewing Co. v. Clarke, 30 F.2d 219, 221-22 (2d Cir. 1929), rev'd on other grounds, 280 U.S. 384 (1930). Another frequently cited definition is that goodwill consists of "... every positive advantage that has been acquired by the old firm in the progress of its business, whether connected with the premises in which the business was previously carried on, or with the name of the late firm, or with any other matter carrying with it the benefit of the business." Menendez v. Holt, 128 U.S. 514, 522 (1888). In In re Brown Mr. Justice Cardozo stated that good will is "a reasonable expectancy of preference... [which] may come from succession in place or name or otherwise to a business that has won the favor of its customers." 242 N.Y. 1, 6, 150 N.E. 581, 582 (1926).

2. In re Deutz's Estate, 105 N.J. Eq. 671, 149 Atl. 257 (Ch. 1930); In re Bottomley's Estate, 92 N.J. Eq. 202, 111 Atl. 605 (Ch. 1920).

3. Basically there are two methods by which the favorable attitudes of customers may be transferred from one proprietor to another. To accomplish this factual result (1) the transferee can be furnished with all the symbols and other transferable attractions which produce a favorable customer response and (2) the transferor can be removed as an alternative attraction. However, regardless of the procedure adopted, the transfer of the goodwill represents only a reasonable or probable expectancy of future patronage because there is no absolute guarantee that the customers who patronized the seller will automatically become the purchaser's customers. Note, *An Inquiry Into the Nature of Goodwill*, 53 COLUM. L. REV. 660 (1953).


and exists only as an incident to other property rights and therefore is not susceptible of being owned and disposed of separately from the business to which it is attached.\(^7\) This is an extreme position since the majority of courts are unwilling to declare that the sale of a business will cause an automatic transfer of goodwill. In the absence of express words providing for the transfer of the goodwill, a court may refuse to imply a sale of this asset, unless the parties' intention to transfer the goodwill can be reasonably inferred from the sales contract.\(^8\) The decisions do, however, display a distinct willingness on the part of the courts to infer such an intent from words appearing in a sales contract.\(^9\) To prevent any doubt as to the parties' intentions to transfer the goodwill, it is incumbent upon the draftsmen of a contract for the sale of a business to include expressly in the sales contract a statement that the goodwill is being sold along with the tangible assets thereof. For purposes of further discussion it will be assumed that the transferee of a business acquires both the tangible assets and the goodwill of the pre-existing organization he has purchased.

**LIMITATIONS IMPOSED UPON THE VENDOR RESULTING FROM THE SALE OF GOODWILL**

As a fundamental rule it is clear that the seller may not derogate from his own grant, \textit{i.e.}, the vendor is not at liberty to destroy or depreciate the value of the goodwill which he has sold. Therefore, any conduct on the part of the vendor that is calculated to impair the value of the goodwill he has conveyed constitutes a breach of promise, implied

\(^7\) Haberle Crystal Springs Brewing Co. v. Clarke, 30 F.2d 219 (2d Cir. 1929), \textit{rev'd on other grounds}, 280 U.S. 364 (1930); Pfleghar Hardware Specialty Co. v. Blair, 30 F.2d 614 (2d Cir. 1929); Hagglin v. Derby, 209 Iowa 939, 229 N.W. 257 (1930). The concept that goodwill is parasitic in nature has been developed to the point where one court has stated that the omission in a sales contract of the mention of goodwill, raises the presumption that it was the intention of the parties that it should pass with the other assets. Gable v. Carpenter, 136 Neb. 669, 287 N.W. 70 (1939). See \textit{In re Gant's Estate}, 356 P.2d 707 (Wash. 1960).

\(^8\) \textit{E.g.}, Potter v. Colvin, 302 S.W.2d 105 (Ky. 1957).

\(^9\) Cornan v. Graeber Stringing & Wire Mach. Co., 69 F. Supp. 550, 553 (E.D. Pa. 1946), \textit{aff'd} 160 F.2d 739 (3d Cir. 1947). Courts have implied such a transfer of the goodwill to the vendee from a sale of the "stock and fixtures" of the business. Lobeck v. Lee-Clark-Andreesen Hardware Co., 37 Neb. 158, 55 N.W. 650 (1893). A court presumed the transfer of goodwill from the sale of all the fixtures and equipment used in the operation of a cafeteria business, including "each and every other thing used in and about the operation of said cafeteria." Engstrom v. Larson, 77 N.D. 541, 561, 44 N.W.2d 97, 108 (1950). Goodwill also was held to pass under an assignment for the benefit of creditors, and a sale under such an assignment. Wilmer v. Thomas, 74 Mo. 485, 22 Atl. 403 (1891); Bank of Tomah v. Warren, 94 Wis. 151, 68 N.W. 549 (1896), from evidence that a plant and business were sold as a going concern. Pfleghar Hardware Specialty Co. v. Blair, 30 F.2d 614 (2d Cir. 1929).

The theory that goodwill passes by implication can be relied upon to support decisions holding that when a withdrawing partner transfers his interest in the firm property to the partners remaining in the firm, he also passes to them his share in the goodwill of the partnership business. See, Menendez v. Holt, 128 U.S. 514, 522 (1888); Brass & Iron Works Co. v. Payne, 50 Ohio St. 115, 33 N.E. 88 (1893).
in the sale, that he will not disturb the vendee in the enjoyment of his purchase.¹⁰ The soundness of this principle is unimpeachable; problems arise solely from attempts to apply it to particular factual settings.

Voluntary Versus Involuntary Sale of A Business

To crystallize the restraints which the law imposes upon the vendor who has parted with his business, it is necessary to distinguish between situations where the vendee acquires the business through a voluntary or involuntary transfer. In Von Bremen v. MacMonnies,¹¹ this distinction was enunciated:

The good will, which the owner thereof parts with in vitum, as in bankruptcy proceedings or by operation of law, as in liquidation of a partnership by the lapse of time or its termination pursuant to the articles of co-partnership, is a lesser property than the good will which is the subject of a voluntary sale and transfer by the owner for a valuable consideration. In the first class of cases the former owner remains under no legal obligation restricting competition on his part in the slightest degree; in the second class of cases the former owner, by his voluntary act of sale, has excluded himself from competing with the purchaser of the good will to the extent of having impliedly agreed that he will not solicit trade from customers of the old business. To this extent this good will (acquired at a voluntary sale) is a more valuable property than the good will of a business (which is acquired through an involuntary sale).

In short, the protection which a vendee in possession of the goodwill of a business acquires through voluntary negotiations is greater than the protection he can expect from the possession of goodwill obtained at an involuntary sale in which the vendor is being coerced through legal means to surrender his business.

Vendor's Involuntary Sale of His Business

The courts are unwilling to restrain an individual from attempting to earn a living where he has been compelled by legal force to forfeit his business, and where he was normally unable to negotiate freely with the vendee or assignee as to the terms under which he was willing to withdraw from the business. In a situation where legal compulsion is the dominant force behind the sale, it would be unrealistic to say that the vendor has, by reason of his receipt of consideration for his business and its goodwill, impliedly promised that he would refrain from doing


anything that would tend to destroy the value of the goodwill. The courts display sympathy towards an individual who has involuntarily sold his business and permit the vendor thereof to re-engage in business and directly compete with the vendee by means of direct solicitation of his former customers. The vendee of goodwill of an involuntarily sold business receives a property right which has little value because of the fact that no competitive restrictions are placed on the vendor.

Vendor's Voluntary Sale Of His Business: The Majority Rule

The law is far less liberal with a vendor who has voluntarily conveyed his business and its goodwill in exchange for a valuable consideration. The leading case, *Trego v. Hunt*, presented the English view on the subject and represents the view followed by a majority of the courts in this country. It held that the vendor could compete with the vendee by using any procedures comparable to the ones that a stranger attempting to compete with the vendee's business would adopt for such a purpose. Therefore, he can "set up where he will," can "push his wares as much as he pleases," and he can "interfere with the customers of his neighbor as a stranger and outsider might do." The major limitations upon the vendor's freedom to compete where he has voluntarily parted with his business are that he cannot capitalize upon any special knowledge which he has of his previous customers so as to regain that which he has been compensated for, and that he can be prohibited from approaching his old customers. See, e.g., *Piggly Wiggly Corp. v. Saunders*, 1 F.2d 572 (W.D. Tenn. 1924), modified on other grounds, 30 F.2d 385 (6th Cir. 1924); *Patterson v. Rogers*, 148 Ark. 222, 229 S.W. 711 (1921); *Farmer's Co-op Elevator of Fowler v. Sturgis & Sons*, 226 Mich. 437, 198 N.W. 191 (1924); *Suburban Ice Mfg. & Cold Storage Co. v. Mulvihill*, 21 Ohio App. 438, 153 N.E. 204 (1926); *Note, Limitations Which Result In Law From The Sale Of The Goodwill Of A Business*, 4 BROOKLYN L. REV. 172 (1934).

12. Mutual Life Ins. Co. v. Menin, 115 F.2d 975, 978 (2d Cir. 1940), *cert. denied*, 313 U.S. 578 (1941); *Beauchamp v. United States*, 76 F.2d 665 (9th Cir. 1935); *Perkins v. Becker's Conservatories, Inc.*, 518 Mass. 407, 61 N.E.2d 833 (1945); *In re Brown*, 242 N.Y. 1, 150 N.E. 581 (1926); *Buffalo Oyster Co. v. Nenno*, 132 Misc. 213, 229 N.Y. Supp. 210 (Sup. Ct. 1928); *James Van Dyk Co. v. F. V. Reilly Co.*, 73 Misc. 87, 130 N.Y. Supp. 755 (Sup. Ct. 1911); *Soeder v. Soeder*, 82 Ohio App. 71, 77 N.E.2d 474 (1947). But see, *S. F. Meyers Co. v. Tuttle*, 183 Fed. 235 (S.D.N.Y. 1910), where sons of the bankrupt transferor formed a corporation and entered into business in the same location and with the identical name used by their father. The court found that the sons were attempting to appropriate to themselves the goodwill of the bankrupt business which had been acquired by the complainant. It enjoined the sons from performing any act which would naturally tend to induce the public into believing that the business formerly conducted by their father was not being carried on by the purchaser. The injunction included a restraint upon the defendants right to use the old company name and prevented them from simulating the letterheads and billheads of their father's former company. However, it can be seen that this case presents special facts justifying the court's conclusion and it does not undermine the validity of the above stated principles.


customers under the guise of his former position. From this early pronouncement of the law, subsequent case law has interpreted this to mean that the vendor can compete in the same locality, and he can make his rival business known by general public advertising. Probably the strongest legal protection given to the vendee against derogation of the value of the goodwill he has acquired, is that the vendor will be restrained from directly soliciting his old customers. Although personal solicitation to persuade old customers to deal with him rather than the vendee is forbidden, indirect, nondeceptive solicitation, by means of general advertisements through such media as radio, newspapers, and television commercials are allowed. In line with this, a court has correctly refused to enjoin a defendant from doing business with old customers who were not especially induced by the rival defendant to come to his establishment, but who rather came solely as a result of exercising their choice as with whom they wished to deal.

Under the majority view the vendor is permitted to use his own name in his rival business, unless words to the contrary appear in the sales

17. See Williams v. Farrand, 88 Mich. 473, 487, 50 N.W. 446, 449 (1891); Washburn v. Dosch, 68 Wis. 436, 32 N.W. 551 (1887).
19. Piggly Wiggly Corp. v. Saunders, 1 F.2d 572 (W.D. Tenn. 1924), modified on other grounds, 30 F.2d 385 (6th Cir. 1924); Von Bremen v. MacMinnies, 200 N.Y. 41, 93 N.E. 86 (1910); Buffalo Oyster Co. v. Nenno, 132 Misc. 213, 229 N.Y. Supp. 210 (Sup. Ct. 1928); Suburban Ice Mfg. Co. v. Mulvihill, 21 Ohio App. 438, 153 N.E. 204 (1926). The restriction imposed upon the vendor's right to solicit directly old customers does not represent a permanent restraint upon him. Rather, the restriction is to exist only for that length of time which the court deems is sufficient for the vendee to attach the goodwill to himself. To hold otherwise, in the opinion of the Ohio Court of Appeals, would have been unreasonable, in restraint of trade, and contrary to public policy. Suburban Ice Mfg. Co. v. Mulvihill, supra.
20. See cases cited note 19 supra.
21. Hilton v. Hilton, 89 N.J. Eq. 182, 104 Atl. 375 (Ct. Err. & App. 1918). In Snyder Pasteurized Milk Co. v. Burton, 80 N.J. Eq. 185, 83 Atl. 907 (Ct. Err. & App. 1912), the court enjoined the defendant from transacting business with old customers who were obtained by direct solicitations. Defendants unsuccessfully contended that the old customers might have returned without solicitation on their part. The court rebutted this by answering that although this could very well have happened, a person by his own inequitable conduct could deprive himself of what otherwise he could have rightly claimed.
22. A man's right to use his own name in connection with his business is a fundamental right. The intention of divesting oneself of it, by transferring his right to another will not be presumed, but must be clearly shown. Ranft v. Reimers, 200 Ill. 386, 65 N.E. 720 (1902); Hilton v. Hilton, 89 N.J. Eq. 182, 104 Atl. 375 (Ct. Err. & App. 1918); Buffalo Oyster Co. v. Nenno, 132 Misc. 213, 229 N.Y. Supp. 210 (Sup. Ct. 1928).
A conflict of authority exists as to whether upon the sale or dissolution of a partnership the purchaser(s), the remaining partner(s) or the withdrawing partner(s) can subsequently use the old firm's name. In Gable v. Carpenter, 136 Neb. 669, 287 N.W. 70 (1939), it
Vendor's Right to Compete

contract, but this right will be denied if it is used in a manner calculated to deceive the public. Such deception permits the vendor to reap the benefits of the business he has sold and results in a depreciation or destruction of the value of the goodwill for which the vendee has paid. To prevent this from occurring, the competing vendor can be enjoined from performing any acts that indicate in any way that he is continuing the old business, or give the impression that the customers will still be dealing with the same business in which he sold the goodwill.

To summarize, as a general rule the voluntary sale of a business and a fortiori, the involuntary sale of a business and its goodwill, does not import an agreement by the vendor not to reengage in a competitive business, according to the majority of courts. Under circumstances of an involuntary sale the vendor has free reign to compete directly with the business conveyed to the best of his abilities. Under the terms of a voluntary sale, these courts hold that the vendor can be restrained from derogating from the value of the property he has conveyed, i.e., from any attempts “to decoy it away or call it back before the purchaser has had time to attach it to himself and make it his very own.”

Minority Views: Massachusetts and Connecticut Rules

Although the doctrine announced in the Trego case, represents the view followed by the great weight of authority in this country, there is clearly no unanimity of opinion on this question in all jurisdictions within the United States. By reaching opposite conclusions, the conflicting views taken by two jurisdictions, Massachusetts and Connecticut, place the majority view in a middle-of-the-road position.

The Massachusetts courts place far greater restrictions upon the ven-

was held that upon the sale or dissolution of a partnership it is normally the succeeding partners who acquire the right to carry on the business under the old firm's name. This was so even though the name of the individual partner selling his interest was the only one that appeared in the firm's name. Accord, Snyder Mfg. Co. v. Snyder, 54 Ohio St. 86, 43 N.E. 325 (1896). Contra, Annot., 173 A.L.R. 444, 466 (1948). See, Edelman Realty Co. v. Edelman, 344 Mich. 646, 75 N.W.2d 29 (1956).


dor's right to compete in a rival business than do the English courts. While subscribing to the basic premise that the vendor of a business can do nothing that will derogate from the goodwill he has sold, they go further in implying from the sale of a business and its goodwill a covenant not to compete. Thus this view expands the protection which the vendee receives from the acquisition of the vendor's goodwill. In each case where the goodwill of a business is voluntarily sold and the vendor sets up a competing business, it is a question of fact, having regard to the character of the business sold and the one set up, whether the new business is in derogation of the sale. If the factual conclusions suggest this result, then the courts prohibit the vendor from operating his rival business. This result is accomplished by finding that the vendor, in consideration of the purchase price he has received for his business and its goodwill, has impliedly agreed to restrict his freedom to engage in a competitive business. Under this approach the courts are willing to imply that which in a majority of jurisdictions requires an express covenant not to compete.

Connecticut and other jurisdictions adopting the Connecticut view are


31. See C. H. Batchelder & Co. v. Batchelder, 220 Mass. 42, 107 N.E. 455 (1914); Foss v. Roby, 195 Mass. 292, 81 N.E. 199 (1907). But see Horvitz v. Zalkind, 332 Mass. 125, 123 N.E.2d 382 (1954). In this case the sales contract contained the covenant that defendant "would not open any store" within a twenty mile radius, for a period of ten years. The court refused to imply a covenant not to compete any broader than the one which appeared in the sales contract. In the absence of an express covenant, the court would have enjoined the defendant from competing in any way with the plaintiff. But by stating specifically what activities the defendant could and could not engage in, the court held that the parties intended to exclude all matters not specifically mentioned and therefore the defendant could compete through the use of an office.
far more liberal with the vendor. Under this view the restrictions upon the vendor's right to compete are enforced only to the extent that they are explicitly spelled out in the sales contract. In the absence of an express covenant the Supreme Court of Tennessee has refused to infer from the transfer of goodwill alone any restraint upon the vendor's right to compete directly with the vendee. This liberal approach in favor of the vendor makes the acquisition of a firm's goodwill of little value unless a covenant not to compete is obtained from the seller simultaneously with the purchase of the business. Otherwise, the vendor may be permitted to engage in a competing business next door to his old location and can by direct personal solicitation attempt to do business with his old customers.

From the above discussion it is apparent that the overwhelming majority of courts impose little restraint upon the vendor from derogating from his grant and afford the vendee only nominal protection. When practical consideration is given to the destructive effect which any competition from a vendor has at a time when the vendee is attempting to establish himself in his newly-acquired business, it is apparent that the vendee must obtain greater protections than those which are acquired solely by the purchase of goodwill. This additional protection is available to the vendee in the form of a covenant not to compete.

**COVENANTS NOT TO COMPETE**

The inclusion of a covenant not to compete in the sales contract is the device used to broaden the otherwise inadequate protection the vendee receives from the acquisition of the vendor's goodwill. The presence of such a restrictive covenant, as an incident to the transfer of the goodwill, extends its practical value by imposing definite restraints upon the vendor, thereby giving the vendee "total protection" for his investment. A restrictive covenant should be incorporated into the normal sales contract, inasmuch as it is the only assured means by which the vendee will be given a full opportunity to reap the benefits of his investment. Caution, however, must be exercised in the drafting of a restrictive covenant.

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32. "Upon a sale of the goodwill of a business, without more, the selling party is not precluded from setting up a precisely similar business at another business stand in the same city, or even in the vicinity. If the purchaser desired to forestall such a step he must expressly stipulate against it in the sales contract." Fine v. Lawless, 139 Tenn. 160, 167, 201 S.W. 160, 162 (1918). Cottrell v. Babcock Printing Press Mfg. Co., 54 Conn. 122, 122, 6 Atl. 791 (1886). See also Brown v. Benzinger, 118 Md. 29, 84 Atl. 79 (1912); Huston v. Dickson, 213 Ore. 115, 322 P.2d 920 (1958).

33. Cases cited note 32, supra.

34. Fine v. Lawless, 139 Tenn. 160, 201 S.W. 160 (1918).

35. All jurisdictions apply the Connecticut rule where there has been an involuntary sale of the vendor's business.

if the vendee is to have a reasonable probability of enforcing the covenant against the vendor. The restraint normally imposed is in the form of prohibitions upon the vendor's right to compete for a specific period of time, within a specific territory. It is these factors, the time limitation and the territorial extent of the restraint, which must be carefully selected to assure enforceability of the covenant. The historical background and development of the law in this area is helpful in determining the extent of a legally enforceable restraint in a particular factual situation.

**Historical Background**

The underlying problem existing in the area of enforcement of restrictive covenants arises from the obvious conflict between society's interest in protecting the freedom of contract and its opposing interest in preserving the right of an individual to earn a living.\(^{37}\) Fortunately, this conflict has been resolved in favor of providing greater protection to the freedom of contract, *i.e.*, the freedom to sell one's property absolutely. The covenant not to compete is the means by which an absolute sale of the vendor's business can be accomplished. This necessarily follows from the fact that it is only where the vendee can be assured of virtually no competition from the vendor that he may be wise to invest his money in such a business. With this in mind, it can be understood that it is the willingness of the courts to enforce such restrictive covenants, though partially in restraint of trade, that makes goodwill a *saleable asset*.\(^{38}\)

At the common law and now under federal and state antitrust statutes contracts in restraint of trade have been held to be unenforceable. Therefore, the problem confronting the draftsmen of the restrictive covenant which is to be included in a sales contract transferring a business or real property is the necessity of avoiding the danger of having the covenant declared unenforceable on the grounds that it is an agreement in restraint of trade.\(^{39}\) The rigidly enforced common-law rule against all agreements which resulted in any restraint of trade was modified in the leading case of *Mitchell v. Reynolds*,\(^{40}\) which distinguished between general and partial restraints of trade, and held that a contract providing

38. 6 CORBIN, CONTRACTS § 1387 (1951).
39. 5 WILLISTON, CONTRACTS § 1633 at 4576 (Rev. ed. 1937), states: "Any bargain or contract which purports to limit in any way the right of either party to work or to do business, whether as to the character of the work or business, its place, the manner in which it shall be done, . . . can be called a bargain . . . in restraint of trade." See also Cameron v. Int'l Alliance, 119 N.J. Eq. 577, 183 Atl. 157 (Ct. Err. & App. 1936), cert. denied, 298 U.S. 659; RESTATEMENT, CONTRACTS § 513 (1932).
Vendor's Right to Compete

for the latter to be enforceable if reasonably restricted as to time and territory. Although the distinction which the court made between general and partial restraints is today invalid, the value of the decision is nevertheless preserved because the language used suggests the now recognized principle that restraints which are reasonably necessary to protect the vendee against competition from the vendor should be enforced. In *United States v. Addyston Pipe and Steel Company*, the court held that one of the five general classes of restraints which are legally enforceable is an agreement "by the seller of property or business not to compete with the buyer in such a way as to derogate from the value of the property sold or business sold."43

Creating Enforceable Covenants — Factors To Be Considered: Reasonableness As To The Parties

The law is clear that restrictive covenants against competition, though in partial restraint of trade, are enforceable if they are reasonable to the covenantee, covenantor, and to the public. In the overwhelming majority of jurisdictions, it is also quite clear that unless an express statement that the vendor agrees not to compete with the vendee is incorporated into the sales contract, no such agreement will be enforced. The basis for the objection to such covenants, namely that they are in restraint of trade, displays itself in the form of unreasonable restrictions as to time or territory. The enforceability of a restrictive covenant is therefore dependent upon the reasonableness of the time to which the covenant has been limited and the area in which the covenant is operative.46

Since the key to the enforceability of restrictive covenants is their reasonableness as to time and territorial limitations, a determination of this can only be made after an examination of all the facts and circum-

41. 6 Corbin, Contracts § 1386 (1951).
42. Ibid.
43. 85 Fed. 271 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899).
44. Id. at 281. In this article, the discussion of restrictive covenants is generally limited to their effect upon conveyances of business and real estate. A conflict exists as to whether principles developed in this area are applicable to covenants between employers and employees. See, Note, Trade Regulations: Employer Protection from Employee Competition after a Term of Employment, 4 Ohio St. L. J. 263 (1939).
45. Cases cited notes 14 and 15 supra.
stances of each case. The fact that the general rule is one of reasonableness indicates that the desirable result in individual cases depends entirely upon the particular circumstances involved.

The validity of a contract in partial restraint of trade or business is not to be determined by the arbitrary measures of extent in time, extent in space, and the like, but by its reasonableness under all the circumstances having regard both for the liberty of a person to make beneficial use of his own, and for the public consequence of such use.

Bearing this in mind, no attempt to set forth any exact number of years or exact territory in which a restraint for a particular type of business can be enforceably imposed will be made in this note. An exhaustive presentation of decisions, classified into various common categories of businesses, years of restraint, and territory of such restraint has already been assembled.

The term "reasonable" has different meanings and requirements when examined in light of the interests of the various parties who are affected by the transaction out of which the restrictive covenant is produced. For this reason, the cases commonly divide the question of reasonableness into three independent categories, that is, reasonableness as to the covenantor, to the covenantee, and to the public.

**Reasonableness As To The Covenantee**

One basic requirement which must be satisfied to prevent the covenant from being rendered unenforceable is that the restraint can be no greater than is necessary for the protection of that which the covenantee has purchased. Inasmuch as the reason for the restraint is to protect the purchaser in the enjoyment of the goodwill he has paid for, there is no justification for a restraining period in excess of the time that the goodwill can reasonably be expected to continue. The purchase of the vendor's goodwill is generally understood to grant to the vendee only the

47. In United States v. Trenton Potteries Co., the court gave recognition to the inherent difficulties involved in defining the term "reasonable." It states that the term is so vague because of its common usage as a "convenient summary of the dominant considerations which control in the application of legal doctrines." 273 U.S. 392, 397 (1927). Bancroft & Rich v. Union Embossing Co., 72 N.H. 402, 57 Atl. 97 (1903); Nat'l Ben Co. v. Union Hosp. Co., 45 Minn. 272, 47 N.W. 806 (1891).


50. Two recent cases which have adopted this procedure in measuring the reasonableness of a restrictive covenant are Welcome Wagon, Inc. v. Morris, 224 F.2d 693, 698 (4th Cir. 1955); Standard Register Co. v. Kerrigan, 119 S.E.2d 533 (S.C. 1961).


52. CORBIN, CONTRACTS § 1391 (1951).
limited right to establish himself favorably with his predecessor's customers and is not considered to be an asset from which the vendee can expect to derive unlimited benefit. This concept suggests a valuable measuring rod in ascertaining a reasonable degree of restraint. To make the restraint reasonable it should be imposed only as long as the personal business and customer relationships of the seller are still such that his competitive business would attract old customers from the buyer. Therefore, the vendor should not be restrained beyond a period of time at which his re-entry into the business would have no greater adverse effect upon the purchaser's business than would similar competition from an absolute stranger. Generally speaking, the greater the importance of the "personal element" of the vendor, the longer the restraining period needed to dispel the competitive advantage of the seller. For example, a professional practitioner who purchases a practice is justified in placing a restriction of longer duration upon the seller. On the other hand, a retail business normally requires only a relatively short period of protection. This is explained by the fact that customers normally visit such stores at relatively short intervals and after patronizing the old establishment, it is unlikely that the seller can regain his advantageous position with them after a relatively short period of time. However, like all generalizations, the above example could well prove to be erroneous in a particular transaction.

Reasonableness As To The Covenantor

Justifiably, the interests or hardships upon the vendor should be given the least consideration in determining the reasonableness of the covenant. It is the writer's opinion that a party who has voluntarily exercised his will and has decided to accept valuable consideration for his business and the goodwill therein, should be shown little sympathy by a court of law. At the time of signing the sales agreement the vendor is fully apprised of the degree of the restraint which he is willingly accepting as a limitation upon his basic right to earn a living. A later change of heart deserves no great consideration. Courts should, and generally do assume this position and display strong reluctance to aid such individuals in their attempts to dissolve an important part of their bargain. It is only in those few cases where the covenant is found to place an impossible hard-

53. Ibid.
54. Webster v. Williams, 62 Ark. 101, 34 S.W. 537 (1896). The court permanently enjoined a physician from practicing where he had expressly agreed to retire from practice. See also Storer v. Brock, 351 Ill. 643, 184 N.E. 868 (1933); Styles v. Lyon, 87 Conn. 23, 86 Atl. 564 (1913).
ship upon the vendor that such an agreement is struck down on grounds of being unreasonable to the vendor. 56

Reasonableness As To The Public

The last element comprising the concept of reasonableness, as applied to time and territorial limitations in restrictive covenants, is that such restrictions must be reasonable for the general public. It is clear that this element is an independent factor which must be given independent consideration.

It is not the interest of the parties alone, which in the eye of the law are to be considered the true test, but in each particular case, under the facts, the judicial inquiry is: Will it be inimical to the public interest? If so, then, and in that event, the agreement must be held as hostile to public policy, and therefore, void. 57 Therefore, even though the restraint may be reasonable between the parties, it still can be found to be injurious to the public interest to the extent that public policy requires it to be declared void. 58

One of the alleged sources of possible injury to the general public is that the elimination of the covenantor from freely participating in a competitive manner with the covenantee deprives the public of the benefits which normally flow from such competition. However, the contention that the severe limitations placed upon the covenantor result in the stifling of competition should not, in and of itself, render the restraint unreasonable as to the general public. Little weight is given to this public policy argument because the courts correctly hold that the public has as great an interest in the freedom and enforcement of contracts as it has in maintaining the freedom of competition. 59 Further, this argument loses any remaining strength when one considers that the restriction upon the vendor's right to compete within a particular locality certainly does not limit anyone else's right to enter a competitive business within the restricted area. 60

The second possible source of injury to the public is that the enforcement of such a restriction results in the community's being deprived of


57. Consumers' Oil Co. v. Nunnemaker, 142 Ind. 560, 561, 41 N.E. 1048, 1050 (1895); see Tarr v. Stearnman, 264 Ill. 110, 105 N.E. 957 (1914).


60. Hultsman v. Carroll, 177 Ark. 432, 6 S.W.2d 551 (1928); Robbins v. Plant, 174 Ark. 639, 297 S.W. 1027 (1927); Hursen v. Gavin, 162 Ill. 377, 44 N.E. 735 (1896).
Vendor's Right to Compete

the covenantor's specialized skill, talent, or profession. This approach, independent of any others, is not sufficiently convincing to be sustained.\(^{61}\) It can be cogently attacked by the argument that the sale of a business or professional practice normally results only in a substitution of ownership rather than the removal of the business unit from the competitive market.

The one area where restraint, *in and of itself*, is commonly found to be against public policy and therefore void, is where it is shown that the purpose for which the covenant was created was solely to suppress competition, thereby creating a monopoly.\(^{62}\)

**Factors to be Considered: Reasonable**

**Territorial and Time Limitations**

**Territorial Limitations**

There is an apparent conflict in the cases as to the extent of territorial limits which can enforceably be included in the covenant not to compete. Some courts hold that the determining factor which establishes the permissible territorial limits of the restraint is the territorial extent in which the business purchased transacted its business.\(^{63}\) Under this view, area included in the restriction is unreasonable if it includes territory into which the buyer afterwards extends his business or territory in which the buyer himself was doing business prior to the purchase.\(^{64}\)

Other courts taking a more liberal view, hold that the territorial scope of the restraint can include territory into which the business might reasonably be expected to expand.\(^{65}\) This latter view seems to be far more consistent with the normal objective of a purchaser to expand and develop the business he has acquired.

**Time Limitations**

A promise not to compete, unlimited as to time, will not be held un-
reasonable per se. The time limitation placed upon the restraint is an important factor to be considered in a determination of reasonableness, but it is not conclusive. The modern trend is to enforce restrictive covenants which are unlimited as to time if they are reasonable in all other respects. Many courts uphold contracts containing unlimited restraints upon time by implying that the restraint is enforceable for a reasonable period of time. Similarly, agreements which are reasonable in all respects but contain no express limitation as to territory are frequently upheld by interpreting the contract as providing for a reasonable limitation in light of all the surrounding circumstances. An early case upheld a restrictive covenant which imposed an unlimited restriction as to time where the nature and the surrounding facts justified the conclusion that it was reasonable. It is the writer's opinion that as long as the basic purpose for the execution of restrictive covenants, that is, to protect the goodwill that the vendee has acquired, by preventing the vendor's re-entry into business, is furthered, such determinations by the courts are desirable. Such covenants should be upheld despite the fact that their broad restrictions have been attacked on the ground of placing too great a hardship upon the covenantor.

**Divisibility of Covenants**

Although a covenant is found to be unreasonable, it may be severed and enforced to the extent of giving reasonable protection to the vendee. A growing majority of jurisdictions permits the partial enforcement of "divisible" covenants if the part of the area in which enforcement would be reasonable is by the wording of the instrument, readily ascertainable. These rules are merely remnants of the common-law "blue-penciling" test by which English courts severed a covenant if it was so worded that the unreasonable elements might be lined out with a "blue pencil" and the remaining elements treated as an independently enforceable condition.

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68. See for example Tarry v. Johnston, 114 Neb. 496, 208 N.W. 615 (1926).


tract. The modern trend of the law, as Professor Williston suggests, is that of severance and partial enforcement of covenants, although the covenant itself may be indivisible. This approach appears sound only where there is proof that the covenant has not deliberately been made oppressive so as to insure partial enforcement rather than none at all.

**CONCLUSION**

The sale of goodwill, ancillary to the sale of a business by itself, does not provide adequate assurance to the purchaser that he will be protected in the enjoyment of the benefits he has paid for. The majority rule, which permits competition by the vendor, has led to the use of the covenant not to compete. Such a covenant, ancillary to an agreement to purchase a business, should be considered an indispensable part of the sales contract. A restrictive covenant, though partially in restraint of trade, can be enforced against the vendor if it is reasonable and imposed only to the extent necessary to preserve the value of the goodwill.

As has been shown, the entire concept which regulates the enforceability of the covenant not to compete is dominated by the requirement that the restraint be a reasonable one. Only after careful consideration of the particular factual circumstances should an attempt be made to determine the number of years and the territorial boundaries from which the vendor is to be restrained. An attempt to impose too great a restraint upon the vendor can very well lead to great hardships in the future for the vendee.

The development of the law in this area suggests a more liberal consideration of the vendee's right and has resulted in a growing tendency to permit greater restraints to be imposed upon the vendor. This means that the vendor must exercise greater caution prior to restricting voluntarily his freedom to earn a living. However, upon acceptance of the covenant, his future rights to compete should be absolutely settled and subsequent attempts to breach the agreement should be prohibited. The growing trend towards favoring the vendee is a desirable one and in accord with modern business practices.

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