

Restatement (Second) of Contracts (1981)

§ 186 Promise in Restraint of Trade

(1) A promise is unenforceable on grounds of public policy if it is unreasonably in restraint of trade.

(2) A promise is in restraint of trade if its performance would limit competition in any business or restrict the promisor in the exercise of a gainful occupation.

Comments:

a. Rule of reason. Every promise that relates to business dealings or to a professional or other gainful occupation operates as a restraint in the sense that it restricts the promisor's future activity. Such a promise is not, however, unenforceable unless the restraint that it imposes is unreasonably detrimental to the smooth operation of a freely competitive private economy. A rule of reason of this kind necessarily has somewhat vague outlines. Whether a restraint is reasonable is determined in the light of the circumstances of the transaction, including not only the particular facts but general social and economic conditions as well. The promise is viewed in terms of the effects that it could have had and not merely what actually occurred. Account is taken of such factors as the protection that it affords for the promisee's legitimate interests, the hardship that it imposes on the promisor, and the likely injury to the public. See § 188 and Comments b and c to that Section. A restraint that is reasonable in some circumstances may be unreasonable in others.

b. Typical restraints. The rule stated in this Section has little impact on some of the most significant promises in restraint of trade. Among the leading examples are promises that are intended to or that tend to create a monopoly, in the sense of control or domination of a market, and those that significantly lessen competition by, for example, tying the purchase of one product to another controlling prices or limiting production. The effect of such restraints is largely governed by federal and state legislation. See Introductory Note to this Topic. (No implication is intended in the Illustrations in this Topic with respect to the application of such legislation.) Another example consists of promises that restrict the alienation of a property interest. These promises usually involve land and such restraints are dealt with as part of the larger problem of restraints on alienation of land in general. See Restatement of Property, Division IV, Part II. Among the residue of promises that are left to be governed by the general common law restriction on promises in restraint of trade, the most commonly

litigated are those to refrain from competition. They are given special treatment in the two sections that follow.

Illustrations:

1. A, B and C, competing manufacturers, promise each other not to sell goods in which they deal at prices below fixed minimums. Their promises are unreasonably in restraint of trade and are unenforceable on grounds of public policy.

2. A, B and C, who are competing merchants in a city where there are many competitors, promise to become partners in order to reduce the expense of doing business. The economic situation of A, B and C is such as to make the partnership reasonable. Their implied promises not to compete individually in the same market are not unreasonably in restraint of trade and enforcement is not precluded on grounds of public policy.

3. A transfers a tract of land in fee simple to B. As part of the transaction, B promises never to transfer the land. B's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. See Restatement of Property § 406.

§ 188 Ancillary Restraints on Competition

(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.

Comments:

[...]

f. Promise by seller of a business. A promise to refrain from competition made in connection with a sale of a business may be reasonable in the light of the buyer's need to protect the value of the good will that he has acquired. In effect, the seller

promises not to act so as to diminish the value of what he has sold. An analogous situation arises when the value of a corporation's business depends largely on the good will of one or more of the officers or shareholders. In that situation, officers or shareholders, either on the sale of their shares or on the sale of the corporation's business, may make an enforceable promise not to compete with the corporation or with the purchaser of its business, just as the corporation itself could on sale of its business make an enforceable promise to refrain from competition.

Illustrations:

1. A sells his grocery business to B and as part of the agreement promises not to engage in a business of the same kind within a hundred miles for three years. The business of both A and B extends to a radius of a hundred miles, so that competition anywhere within that radius would harm B's business. The restraint is not more extensive than is necessary for B's protection. A's promise is not unreasonably in restraint of trade and enforcement is not precluded on grounds of public policy.

2. The facts being otherwise as stated in Illustration 1, neither A's nor B's business extends to a radius of a hundred miles. The area fixed is more extensive than is necessary for B's protection. A's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. As to the possibility of refusal to enforce limited to part of the promise, see § 184(2).

3. A sells his grocery business to B and as part of the agreement promises not to engage in business of any kind within the city for three years. The activity proscribed is more extensive than is necessary for B's protection. A's promise is unreasonably is restraint of trade and is unenforceable on grounds of public policy. As to the possibility of refusal to enforce only part of promise, see § 184(2).

4. A sells his grocery business to B and as part of the agreement promises not to engage in a business of the same kind within the city for twenty-five years, although B has ample opportunity to make A's former good will his own in a much shorter period of time. The time fixed is longer than is necessary for A's protection. A's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. As to the possibility of refusal to enforce only part of the promise, see § 184(2).

5. A, a corporation, sells its business to B. As part of the agreement, C and D, officers and large shareholders of A, promise not to compete with B within the territory in which A did business for three years. Their promises are not unreasonably in restraint of trade and enforcement is not precluded on grounds of public policy.

g. Promise by employee or agent. The employer's interest in exacting from his employee a promise not to compete after termination of the employment is usually explained on the ground that the employee has acquired either confidential trade information relating to some process or method or the means to attract customers away from the employer. Whether the risk that the employee may do injury to the employer is sufficient to justify a promise to refrain from competition after the termination of the employment will depend on the facts of the particular case. Post-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood. This is especially so where the restraint is imposed by the employer's standardized printed form. Cf. § 208. A line must be drawn between the general skills and knowledge of the trade and information that is peculiar to the employer's business. If the employer seeks to justify the restraint on the ground of the employee's knowledge of a process or method, the confidentiality of that process or method and its technological life may be critical. The public interest in workable employer-employee relationships with an efficient use of employees must be balanced against the interest in individual economic freedom. The court will take account of any diminution in competition likely to result from slowing down the dissemination of ideas and of any impairment of the function of the market in shifting manpower to areas of greatest productivity. If the employer seeks to justify the restraint on the ground of the employee's ability to attract customers, the nature, extent and locale of the employee's contacts with customers are relevant. A restraint is easier to justify if it is limited to one field of activity among many that are available to the employee. The same is true if the restraint is limited to the taking of his former employer's customers as contrasted with competition in general. A restraint may be ancillary to a relationship although, as in the case of an employment at will, no contract of employment is involved. Analogous rules apply to restraints imposed on agents by their principals. As to the duty of an agent not to compete with his principal during the agency relationship, see Restatement, Second, Agency §§ 393, 394.

Illustrations:

6. A employs B as a fitter of contact lenses under a one-year employment contract. As part of the employment agreement, B promises not to work as a fitter of contact lenses in the same town for three years after the termination of his employment. B works for A for five years, during which time he has close relationships with A's customers, who come to rely upon him. B's contacts with

A's customers are such as to attract them away from A. B's promise is not unreasonably in restraint of trade and enforcement is not precluded on grounds of public policy.

7. A employs B as advertising manager of his retail clothing store. As part of the employment agreement, B promises not to work in the retail clothing business in the same town for three years after the termination of his employment. B works for A for five years but does not deal with customers and acquires no confidential trade information in his work. B's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. Compare Illustration 1 to § 185.

8. A employs B as an instructor in his dance studio. As part of the employment agreement, B promises not to work as a dance instructor in the same town for three years after the termination of his employment. B works for five years and deals directly with customers but does not work with any customer for a substantial period of time and acquires no confidential information in his work. B's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy.

9. A employs B as a research chemist in his nationwide pharmaceutical business. As part of the employment agreement, B promises not to work in the pharmaceutical industry at any place in the country for three years after the termination of his employment. B works for five years and acquires valuable confidential information that would be useful to A's competitors and would unreasonably harm A's business. B can find employment as a research chemist outside of the pharmaceutical industry. B's promise is not unreasonably in restraint of trade and enforcement is not precluded on grounds of public policy.

10. A employs B to work with rapidly changing technology, some parts of which entail valuable confidential information. As part of the agreement B promises not to work for any competitor of A for ten years after the termination of the employment. The confidential information made available to A will probably remain valuable for only a much shorter period. The time fixed is longer than is necessary for A's protection. B's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. As to the possibility of refusal to enforce only part of the promise, see § 184(2).

h. Promise by partner. A rule similar to that applicable to an employee or agent applies to a partner who makes a promise not to compete that is ancillary to the partnership agreement or to an agreement by which he disposes of his partnership interest. The same is true of joint adventurers, who are treated as partners in this respect.

Illustrations:

11. A, B and C form a partnership to practice veterinary medicine in a town for ten years. In the partnership agreement, each promises that if, on the termination of the partnership, the practice is continued by the other two members, he will not practice veterinary medicine in the same town during its continuance up to a maximum of three years. The restraint is not more extensive than is necessary for the protection of each partner's interest in the partnership. Their promises are not unreasonably in restraint of trade and enforcement is not precluded on grounds of public policy.

12. A, an experienced dentist and oral surgeon, takes into partnership B, a younger dentist and oral surgeon. In the partnership agreement, B promises that, if he withdraws from the partnership, he will not practice dentistry or oral surgery in the city for three years. Their practice is limited to oral surgery, and does not include dentistry. The activity proscribed is more extensive than is necessary for A's protection. B's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. As to the possibility of refusal to enforce only part of the promise, see § 184(2).

13. A works for five years as a partner in a nationwide firm of accountants. In the partnership agreement, A promises not to engage in accounting in any city where the firm has an office for three years after his withdrawal from the partnership. The firm has offices in the twenty largest cities in the United States. A's promise imposes great hardship on him because this area includes almost all that in which he could engage in a comparable accounting practice. The promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy. As to the possibility of refusal to enforce only part of the promise, see § 184(2).

14. A, a doctor who has a general practice in a remote area, takes into partnership B, a younger doctor. In the partnership agreement, B promises that, if he withdraws from the partnership, he will not engage in the practice of medicine within the area for three years. If B's unavailability in the area will be likely to cause injury to the public because of the shortage of doctors there, the court may determine that B's promise is unreasonably in restraint of trade and is unenforceable on grounds of public policy.

15. A and B attend an art auction and each plans to bid on a valuable painting. They decide to acquire it as a joint venture and each promises the other to bid for its purchase jointly and, if successful, to deal with it jointly. Their promises are not unreasonably in restraint of trade and are not unenforceable on grounds of public policy. Compare Illustrations 3 and 4 to § 187.