# FREEDOM OF CONTRACT VS. THE RIGHT TO WORK: AN ANALYSIS AND SOME THOUGHTS ON IOWA'S COVENANT NOT TO COMPETE LAW

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ABSTRACT

*Iowa attorneys often struggle when asked to interpret provisions in contracts that attempt to limit competition by employees after the employment relationships ends. When asked whether a given covenant not to compete is enforceable, many attorneys respond by acknowledging that even though covenants limiting competition are generally enforceable in Iowa, whether a judge will enforce a particular covenant depends on a number of factors. Thus, it is difficult, if not impossible, to predict with any meaningful precision how a court will rule on a dispute over a covenant not to compete—and few clients are satisfied by such a response.*

*This Article attempts to add some clarity to the subject. The Author provides a detailed discussion of the considerable case law that exists regarding restrictive covenants, with an emphasis on the specific factors Iowa courts apply when determining whether to enforce a given covenant. The Author also offers practical advice to assist practicing attorneys attempting to apply the existing case law to actual situations.*

*Additionally, the Author urges the Iowa Supreme Court to adopt the "customer-specific restraint" approach that the Nebraska Supreme Court adopted in 1987. This approach permits employers to only prohibit former employees from contacting customers or clients with whom the former employee had prior contact. The Author contends a limited approach of this nature properly balances the competing interests involved, and more importantly, it*

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*adds predictability to the uncertainty that currently confounds Iowa judges and attorneys.*

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## I. INTRODUCTION

A successful stockbroker calls his attorney on the telephone. The stockbroker says he wants to leave his current firm to join a different firm. The stockbroker has a sizeable book of business that he is confident will follow him. The stockbroker asks his attorney if there are any problems that may arise if the stockbroker departs. While the attorney is getting ready to discuss some of the trade secret and piracy issues the stockbroker may encounter should he choose to depart, the stockbroker adds the following: "Oh, one more thing: A couple of years ago I signed an employment agreement that prohibits me from competing against my current firm. But, I hear those things are not worth the paper they are written on." The attorney sighs heavily and advises the stockbroker that he is misinformed—at least within this state.

For over fifty years, Iowa courts have enforced contract provisions that limit or prohibit employees from competing against their employers after the employment relationship ends.[1] Commonly referred to as

1. The Iowa Supreme Court's willingness to enforce restrictive covenants dates back to *Brecher v. Brown*, 17 N.W.2d 377 (Iowa 1945). In that decision, the Iowa Supreme Court refused to enforce a noncompete provision that prohibited an employee from engaging in the practice of veterinary medicine or surgery within Storm Lake, Iowa, or within twenty-five miles of that city. *Id.* at 377–78. Even though it found in favor of the departing veterinarian, the court noted that the "common law doctrine banning contracts in general restraint of trade" was lifted in *Swigert & Howard v. Tilden*, 97 N.W. 82 (Iowa 1903). *Id.* at 378. The court also remarked that covenants attempting to restrict the employment of another were enforceable if "only as to afford a fair protection to the interests of the party in favor of whom it is given, and not so large as to interfere with the interests of the public." *Id.* at 379 (quoting *Swigert*, 97 N.W. at 85) (internal quotation marks omitted). With that passage, the court opened the door to later decisions in which the Iowa Supreme Court and the Iowa Court of

"covenants not to compete" or "restrictive covenants," provisions of this nature preclude or limit employees from competing against their employer, not only while the employment relationship continues, but for a given period of time (e.g., one, two, or three years) after the employment relationship terminates.[2] Iowa courts have, at times, expressed general disfavor toward covenants not to compete, labeling them "restraints of trade [that] limit an employee's freedom of movement among employment opportunities."[3] Nonetheless, the Iowa Supreme Court, the Iowa Court of Appeals, and the federal courts located in Iowa have all enforced carefully drawn covenants not to compete despite the negative effect the covenants potentially have on individual freedom and labor market mobility.[4]

When reviewing covenants not to compete, Iowa courts attempt to balance the competing interests at stake. The specific interests courts consider include: the employer's interest in protecting its business; the employee's interest in pursuing their chosen trade or profession; and the state's interest in promoting a robust and nimble employment market.[5] Thus, when determining whether a given covenant not to compete is enforceable, Iowa courts address each of the following issues: (1) whether the restriction is reasonably necessary to protect a legitimate business

Appeals enforced less open-ended restrictive covenants. *See, e.g.*, Ma & Pa, Inc. v. Kelly, 342 N.W.2d 500, 501–02 (Iowa 1984) (listing cases in which the Iowa Supreme Court upheld and refused to uphold "covenants prohibiting competition incidental to employment contracts").

2. Although employment agreements containing covenants prohibiting competition usually prevent employees from competing against the employer while the employee is employed and after the employment relationship ends, the former restriction is somewhat superfluous because the Iowa Supreme Court has recognized that a promise not to compete while the employment relationship is ongoing "is implied in every employment relationship." Nelson v. Agro Globe Eng'g, Inc., 578 N.W.2d 659, 662 (Iowa 1998); *see also* H.W. Gossard Co. v. Crosby, 109 N.W. 483, 487 (Iowa 1906) ("[S]o long as the employé [sic] remains in the employer's service there is ordinarily an implied undertaking that he will not engage in any other service or business to the detriment of his employer's interests.").

3. Revere Transducers, Inc. v. Deere & Co., 595 N.W.2d 751, 761 (Iowa 1999).

4. *See* Curtis 1000, Inc. v. Youngblade, 878 F. Supp. 1224, 1256–57 (N.D. Iowa 1995) ("Even today, every time a noncompetition clause is litigated, the court is forced to grapple with two conflicting policies, freedom to contract and the doctrine against contractual restraints of trade."). *Curtis 1000* contains an exhaustive discussion of the law regarding covenants not to compete, including a discussion on how the concept has developed nationally, within Iowa, and, due to a conflict-of-law issue, within the state of Delaware. *Id.* at 1256–69.

5. *See Brecher*, 17 N.W.2d at 379.

interest of the employer, (2) whether the restriction unreasonably restricts the employee's right to work, and (3) whether the restriction prejudices public interest.[6]

Under Iowa law, "[t]he employer has the initial burden [of showing] that enforcement of the covenant is reasonably necessary to protect its business."[7] In addition, the judicial scale is tipped—at least in theory—in the employee's favor, because restrictive covenants are "strictly construed against the one seeking injunctive relief,"[8] and "[t]he restriction must be no greater than that necessary to protect the employer."[9] Stated differently, "the covenant must not be oppressive or create hardships on the employee out of proportion to the benefits the employer may be expected to gain."[10] Each factor is discussed in detail below.

## II. REASONABLY NECESSARY TO PROTECT THE EMPLOYER'S BUSINESS

The primary business interest employers seek to prevent by requiring their employees to sign restrictive covenants is the interest in preventing departing employees from "pirating" customers or clients.[11] For that interest to apply, Iowa courts have required the employer show the employee had "close proximity to customers" coupled with "peculiar knowledge gained through employment that provides a means to pirate the customer."[12] In contrast, the interest is inapplicable when the employee had "little customer contact" or when the employee had extensive customer contact but "did [not] possess any special training or peculiar knowledge that would allow [the employee] to unjustly enrich himself at the expense

6. *See Ma & Pa, Inc.*, 342 N.W.2d at 502 (citing Iowa Glass Depot, Inc. v. Jindrich, 338 N.W.2d 376, 381 (Iowa 1983)).

7. Dental E., P.C. v. Westercamp, 423 N.W.2d 553, 555 (Iowa Ct. App. 1988) (citations omitted).

8. Cogley Clinic v. Martini, 112 N.W.2d 678, 681 (Iowa 1962).

9. Bd. of Regents v. Warren, No. 08-0017, 2008 WL 5003750, at *4 (Iowa Ct. App. Nov. 26, 2008) (citing Mut. Loan Co. v. Pierce, 65 N.W.2d 405, 407 (Iowa 1954)).

10. *Iowa Glass Depot, Inc.*, 338 N.W.2d at 381 (citations omitted).

11. Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, 373 (Iowa 1971); *see also* Moore Bus. Forms, Inc. v. Wilson, 953 F. Supp. 1056, 1065 (N.D. Iowa 1996) ("[C]lose customer contact and peculiar knowledge of former customers' business practices, . . . the opportunity to take some part of the employer's goodwill and the reasonable expectation that some of the employer's customers will follow the employee to the new employment are all factors weighing in favor of enforcing a restriction covenant." (citations omitted)).

12. *Iowa Glass Depot, Inc.*, 338 N.W.2d at 382 (citations omitted).

of [the] former employer."[13] Further, "[t]he justification for the covenant is determined at the time the covenant was executed."[14]

Applying these rules, the Iowa Supreme Court held in *Iowa Glass Depot v. Jindrich* that a covenant prohibiting a store manager from creating a competing glass installation business was not reasonably necessary to protect his former employer's interest in retaining its customers.[15] The court reached that conclusion because, among other things, the employee did not directly solicit customers or "avail himself of a list of exclusive customers or other peculiar knowledge gained in employment to pirate away Glass's customers."[16] The employee in *Iowa Glass Depot* simply opened a competing store.[17] In declining to enforce the covenant, the court contrasted the store manager's situation in which "everyone is a [potential] customer" with its prior "route cases" in which a sales representative was given specialized training and assigned a designated sales territory or customer base to cultivate.[18] The court reasoned that, in those latter instances, the covenant protected the employer's business and was potentially enforceable because it was "only fair on termination of [the employee's] employment [that] there be an interval when a new employee will be able to get acquainted with the customers."[19]

The distinction the Iowa Supreme Court drew in *Iowa Glass Depot* between a store manager and a route salesman—who calls on specific accounts and customers[20]—seems rather quaint in today's global and digital economy, in which goods and services are sold and retained around the world at warp speed and few sales representatives' activities are limited to defined routes, customers, or market segments. Still, the distinction is instructive in that it makes clear that to be legitimate, an employer's interest in not having its customers pirated must involve more than the abstract threat that customers will follow a departing employee to their

13. *Id.* (citations omitted).

14. Sutton v. Iowa Trenchless, L.C., 808 N.W.2d 744, 751 (Iowa Ct. App. 2011) (citing *Ehlers*, 188 N.W.2d at 373).

15. *Iowa Glass Depot, Inc.*, 338 N.W.2d at 384.

16. *Id.* at 383 (citing Federated Mut. Implement v. Erickson, 110 N.W.2d 264, 268 (Iowa 1961)).

17. *Id.* at 378.

18. *Id.*

19. *Id.* at 383 (quoting Mut. Loan Co. v. Pierce, 65 N.W.2d 405, 409 (Iowa 1954)).

20. *See id.* at 382–83.

new business.[21] Rather, the employer, it would seem, must show there is a cognizable risk that specific customers, with whom the employer had regular contact as a result of his former employment, will follow the departing employee if the restrictive covenant is not enforced.[22]

The previously described stockbroker hypothetical can be used to demonstrate this point. If the stockbroker was assigned or inherited significant accounts when he began his employment, then the firm probably has a legitimate interest in preventing the stockbroker from taking those clients and accounts with him if he leaves the firm. Likewise, if the stockbroker developed the "book of business" he seeks to call his own primarily because of the resources he had access to during his employment, or as a result of the goodwill and business reputation of the firm he seeks to leave, then that firm probably has a legitimate business interest in preventing the stockbroker from flipping that business. If, on the other hand, the stockbroker had a sizeable book of business when he joined his current firm, or if the stockbroker developed his book of business largely through his own effort, knowledge, personality, and resources, then the firm's claim to the accounts it seeks to preserve is more attenuated and its interest in retaining that business is less legitimate. In the latter situation, a court may be more inclined to regard the broker's clients and accounts as belonging to the broker and thus, be less inclined to enforce any covenant that precludes the broker from continuing to represent those individuals.

21. *See* Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, 373 (Iowa 1971)).

22. This type of proof was discussed in *Moore Business Forms, Inc. v. Wilson*. In *Moore*, the court enforced a two-year restrictive covenant that prohibited two former sales representatives of Moore Business Forms from selling business forms and related products to customers with whom the sales representatives "sold any product or service or otherwise dealt with during the *one year* preceding the end of their employment with Moore." Moore Bus. Forms, Inc. v. Wilson, 953 F. Supp. 1056, 1059 (N.D. Iowa 1996) (footnote omitted) (internal quotation marks omitted) (citing the covenants within the employment agreement). In the injunction it issued, the court prohibited the defendants from selling business forms and related products to eight specific customers for whom, according to the court, "the defendants played a key role in securing and servicing a significant volume of business." *Id.* at 1067. Further, in rejecting the defendants' argument that the employer did not have a legitimate interest to protect in enforcing the restrictive covenants because the products at issue—business forms—were "ordinary goods" and not services, the court noted that the defendants had, despite their arguments to the contrary, secured important contacts through their employment with Moore. *Id.* at 1065. The court noted that "[t]he record reveals numerous references to sales calls, conferences, and meetings with executives of [the business's] clients." *Id.* Those contacts explained, at least in part, why "the defendants' sales record since leaving [the business] reflect[ed] [a] significantly higher success rate in securing sales to their former . . . clients than to their new client list." *Id.*

The same would be true if the stockholder managed other brokers and no longer had direct or frequent client contact.

Another significant business interest that restrictive covenants are put in place to protect is the prevention of a former employee from disclosing proprietary information the former employee acquires or obtains as a result of their employment.[23] For that interest to apply, the information or know-how at issue must arguably qualify as a trade secret or otherwise warrant the court's protection.[24] To qualify as a trade secret, the information or know-how must, among other things, be truly secret and it must provide the person possessing the information a distinct advantage in the marketplace.[25]

If an employer entrusts its employees with information that truly constitutes a trade secret under Iowa law, then it is difficult to argue that the employer does not have a legitimate interest in preventing that employee from joining a competing company, particularly if the employee may feel compelled to disclose the information to meet the requirements of the new job. Indeed, covenants not to compete, while not necessarily required, are one reasonable method employers use to protect their trade secrets.[26] If the information does not constitute a trade secret because it is generally known or does not give the former employer any type of competitive advantage, then the employer's interest in protecting the information is suspect at best.[27] Notably, not all customer lists constitute trade secrets under Iowa law.[28] Further, an employer's reliance on a former employee's access to a customer list as the exclusive business interest it seeks to protect is somewhat circular; it begs the question of whose customers are on the list for which protection is sought—the employer's or

23. *See, e.g.*, Bd. of Regents v. Warren, No. 08-0017, 2008 WL 5003750, at *5 (Iowa Ct. App. Nov. 26, 2008) ("In considering whether a restriction is reasonably necessary for an employer's business, we also look to whether the employee has obtained confidential knowledge and the nature of the business and the occupation." (citations omitted)).

24. Baker v. Starkey, 144 N.W.2d 889, 896–97 (Iowa 1966) ("Under a reasonable contract the employer is entitled to be protected against an employee's use of trade secrets and personal influence with customers he had gained in such employment.").

25. *See* Thomas W. Foley, *Keeping a Company's Confidences Secret: Trade Secret Enforcement Under Iowa's Uniform Trade Secrets Act*, 59 DRAKE L. REV. 1, 6–10 (2010).

26. *See id.* at 25–26.

27. *See id.* at 6.

28. *Id.* at 17–21.

the former employee's?

The final business interest Iowa courts recognize as potentially supporting a covenant not to compete is the employer's interest in obtaining a fair return for any investment the employer made in the employee.[29] The employer can meet its burden in this regard by showing that during their employment, the former employee received "special training or peculiar knowledge that would allow [the former employee] to unjustly enrich himself at the expense of [the employee's] former employer."[30]

In *Dain Bosworth Inc. v. Brandhorst*, the Iowa Court of Appeals found that the employer, Dain Bosworth, had a protectable business interest in restricting the competition of Brandhorst, a former stockbroker with the firm, because shortly after hiring him, Dain sent Brandhorst out of state for four months of training at a cost of approximately $20,000.[31] The training allowed Brandhorst to secure his brokerage license and to begin selling securities.[32] However, sixteen months after receiving the training, Brandhorst resigned and joined one of Dain's competitors.[33] To add insult to injury, Brandhorst sent solicitation letters to customers with whom he had dealings during his short employment with Dain.[34] Both actions violated the noncompetition agreement Brandhorst signed as a condition to receiving the four-month training.[35]

In enforcing the noncompetition agreement between Dain and Brandhorst, the court held Dain met its "initial burden of proving the noncompetition agreement was reasonably necessary to protect its business," finding that "Dain's $20,000 investment in training Brandhorst" constituted "special training" that permitted Brandhorst to "unjustly enrich himself at the expense of his former employer" within the meaning of the applicable standard.[36] Although the court did not explain its findings in great detail, key factors to the court's decision appear to be the magnitude

29. *See* Orkin Exterminating Co. v. Burnett, 146 N.W.2d 320, 324 (Iowa 1967).

30. Iowa Glass Depot, Inc., v. Jindrich, 338 N.W.2d 376, 382 (Iowa 1983) (citations omitted).

31. Dain Bosworth Inc. v. Brandhorst, 356 N.W.2d 590, 593 (Iowa Ct. App. 1984).

32. *Id.* at 591–92.

33. *Id.* at 592.

34. *Id.*

35. *Id.* at 592–93.

36. *Id.* at 593.

of Dain's investment ($20,000) and the short duration between the training period and Brandhorst's departure (sixteen months).[37] In addition, the training Dain provided permitted Brandhorst to obtain a broker license, which he then used to compete directly with Dain.[38]

Although we will never know for sure, it is likely the court in *Dain Bosworth* would have reached a different conclusion had any one of the factors listed previously been different. For example, had Brandhorst received the same training for the same duration but remained with Dain for twenty years before departing and joining a competitor, the court would have been less inclined to conclude the noncompetition agreement was reasonably necessary to protect Dain's initial investment, or that Brandhorst would be unjustly enriched if the court permitted him to work elsewhere. Having received the benefit of Brandhorst's labor for twenty years, a strong argument would be made that Dain more than recouped its initial investment and that Brandhorst more than repaid any obligation he owed to Dain.

In a similar fashion, the court may have reached a different result had the provisions prohibiting competition been more onerous. The noncompetition agreement Dain requested the court to enforce was narrowly tailored to protect Dain's investment[39] and only prohibited Brandhorst from soliciting former clients or joining a securities dealer within thirty miles of any Dain office.[40] Further, the limitations remained in effect for only ninety days after Brandhorst's employment ended.[41] The court may have concluded more onerous limitations, such as prohibiting a former employee from working within 100 miles of the employer or a covenant lasting two years, would have required Brandhorst to pay too high a price for the training he received and would have gone beyond what was necessary for Dain to recoup its initial investment—particularly if Brandhorst had offered to reimburse Dain for its initial expenditure.

An employer's prior investment in its employees was also at issue in *Dan's Overhead Doors & More, Inc. v. Wennermark*, a case involving three hourly service technicians who left their employment at an overhead door company to join a competing company.[42] In attempting to enjoin the

37. *Id.* at 592–93.
38. *Id.* at 591–92.
39. *See id.* at 593–94.
40. *Id.* at 591–92.
41. *Id.*
42. Dan's Overhead Doors & More, Inc. v. Wennermark, No. 06-1049, 2007

technicians from working for its competitor, Dan's Overhead Doors & More argued that the two-year noncompete provision the technicians signed was "reasonably necessary to protect" the "significant time and assets" the company had invested in "training and developing" the three technicians.[43] In making that argument, Dan's Overhead Door "describe[d] its investment as not only the payment of wages and benefits, but also training costs, exposure to and instruction in leading door industry education, welding and safety instruction, [and] on-the-job training."[44] Dan's Overhead Doors added that, in addition to those investments, it was required to bear inefficiencies while the three technicians learned their craft including the "warranty expense of paying for imperfect installation and repair."[45]

The Iowa Court of Appeals rejected Dan's Overhead Doors' arguments and affirmed the district court's denial of the business's request for injunctive relief and dismissal of the action.[46] In its decision, the court focused on the technicians' individual contributions to their own success, characterizing them as "common laborers who began as entry-level service technicians and through training, practice, and dedication to their trade progressed to be highly-skilled service technicians."[47] While acknowledging that the three were "talented service technicians," the court did not find that "their skills [were] unique, extraordinary, or not capable of being readily replaced."[48] More importantly, for further analysis, the court distinguished the facts before it from a case in which "the employees possessed unique or extraordinary skills which made them irreplaceable" or a case in which "former employees attempted to solicit customers, took trade secrets, or even had access to valuable financial information."[49] While acknowledging that "it was undoubtedly painful for [the employer] to lose their services to a local competitor," the employer's investment in the three technicians, "standing alone, [wa]s not sufficient justification to find enforcement of the covenant reasonably necessary to protect [the employer's] business."[50]

WL 1486133, at *1–2 (Iowa Ct. App. May 23, 2007).

43. *Id.* at *2.
44. *Id.*
45. *Id.* (internal quotation marks omitted).
46. *Id.* at *4.
47. *Id.*
48. *Id.* at *3–4.
49. *Id.* at *4.
50. *Id.*

The decision in *Dan's Overhead Doors* provides useful guidance in determining which employer interests will be considered sufficiently compelling to justify the restriction of a former employer's competition. It appears clear from the decision in *Dan's Overhead Doors*, as well as the decision in *Dain Bosworth*, that Iowa courts will find an otherwise reasonably restrictive covenant necessary to protect a legitimate interest of the employer if the covenant seeks to restrict competition from any of the following types of employees: (1) sales representatives whose departure will result in "a direct loss of customers";[51] (2) high-level employees who have access to key financial information or detailed business plans that they will be compelled to disclose if they go to work for a competitor;[52] or (3) employees who, as a result of the employer's investment, possess unique or extraordinary skills that make them irreplaceable.[53] In contrast, a strong argument can be made that covenants seeking to restrict the competition of employees who do not fall into one of these three categories are not reasonably necessary to protect a legitimate business interest and are not enforceable—no matter how reasonable they might be in scope and duration.

## III. UNREASONABLY RESTRICTIVE OF THE EMPLOYEE'S RIGHTS

One of the interests a court must balance when deciding whether to enforce a covenant not to compete is the employee's interest in being able to pursue their chosen trade or profession.[54] This interest is not only fundamental to this country's market-based economy, but it also underlies the presumption in favor of at-will employment that lies in the heart of Iowa's employment jurisprudence. In Iowa, employment is considered at will when either the employer *or the employee* can terminate the

51. *See id.* at *3.

52. *See* Dain Bosworth Inc. v. Brandhorst, 356 N.W.2d 590, 593 (Iowa Ct. App. 1984).

53. *See Dan's Overhead Doors*, 2007 WL 1486133, at *4.

54. *See* Larsen v. Burroughs, 277 N.W. 463, 465 (Iowa 1938) ("The privilege of a duly licensed physician to practice his chosen profession when and where he may wish is a right which the courts will zealously protect . . . ." (quoting the decree of the trial court) (internal quotation marks omitted)); *see also* Baker v. Starkey, 144 N.W.2d 889, 896–97 (Iowa 1966) (recognizing that an "employer is entitled to be protected against an employee's use of trade secrets and personal influence with customers he had gained in such employment," but observing that such an interest "is naturally subject to the competing interests of the employee's right to work and society's interest in free competition and trade").

employment relationship at any time, for any legal reason.[55] An employee's ability to terminate the at-will employment relationship arguably has little practical effect if the employee's employment possibilities are significantly curtailed when the employment relationship ends.

The employee's interest in being able to pursue a chosen profession is particularly acute when, as is often the case, the employee was employed at will throughout the employee's former employment and was not offered any additional consideration to obtain the promise not to compete. Although, under Iowa law, continued employment constitutes adequate consideration to enforce a restrictive covenant,[56] an argument can be made that the employee's interest in pursuing a certain profession outweighs an employer's interest in enforcing the restrictive covenant when the employer never guaranteed the employee continued employment for a specific duration or paid any additional amount to secure the employee's promise to restrict future employment activities.[57] This is particularly true when the former employer unilaterally terminates the employment relationship and then seeks to enforce any restrictive covenant that may apply. In those instances, the employee's interest in continuing to work in a chosen profession should outweigh any countervailing interest that may apply. Having given nothing of substance to secure the promise not to compete while the employment relationship was ongoing, the former employer cannot reasonably expect to obtain anything of value after the employment relationship terminates.

In determining whether a particular covenant not to compete is

55. *See* Berry v. Liberty Holdings, Inc., 803 N.W.2d 106, 109 (Iowa 2011) (stating that "Iowa is an at-will employment state, mean[ing] that, absent a valid contract of employment, the employment relationship is terminable by either party at any time, for any reason, or no reason at all" (quoting Fitzgerald v. Salsbury Chem., Inc., 613 N.W.2d 275, 280 (Iowa 2000) (internal quotation marks omitted))).

56. *See* Farm Bureau Serv. Co. of Maynard v. Kohls, 203 N.W.2d 209, 212 (Iowa 1972) (rejecting the notion that continued employment is insufficient consideration to support a covenant not to compete).

57. Although Iowa courts have enforced restrictive covenants in cases involving former employees who were employed at will, the Iowa Supreme Court in *Brecher v. Brown* questioned the reasonableness of a restrictive covenant that was "entirely unlimited as to time and ha[d] no relationship to the duration of the employment which the contract expressly made indefinite." Brecher v. Brown, 17 N.W.2d 377, 380 (Iowa 1945). With respect to that situation, the court stated "[t]he indefiniteness in the time of employment does not render the contractual restriction without consideration but it is to be taken into account in appraising the reasonableness of the restriction." *Id.*

reasonably restrictive of the employee's rights, Iowa courts have stated that "the restriction on the employee must be no greater than necessary to protect the employer," and that "the covenant must not be oppressive or create hardships on the employee out of proportion to the benefits the employer may be expected to gain."[58] For this balance to be struck, a court generally will "examine both the time and area restrictions contained in the covenant."[59] To be enforceable, the restrictions must be "tightly limited as to both time and area."[60] Iowa courts also make it clear that "[t]he burden of proving reasonableness is upon the employer who seeks to enforce such a covenant."[61]

Despite the requirement that the period of enforcement in a restrictive covenant be "tightly limited,"[62] Iowa courts have enforced, with little discussion, restrictive covenants that are two years in length or less.[63] In addition, Iowa courts have enforced restrictive covenants lasting up to seven years when the covenant was entered into as part of the sale of the business or was otherwise the product of an arm's-length exchange.[64] Even though they have readily approved restrictive covenants lasting two years or less,[65] Iowa courts have not explained with any degree of particularity why restrictive covenants of that length do not unduly impinge the employee's freedom of contract or right to work. Likewise, Iowa courts have not identified what factors, if any, should be applied when making that determination.

When attempting to determine if a given period of time unduly restricts an employee's freedom of contact or right to work, courts should

58. Iowa Glass Depot, Inc. v. Jindrich, 338 N.W.2d 376, 381 (Iowa 1983) (citations omitted).

59. *Id.*

60. Lemmon v. Hendrickson, 559 N.W.2d 278, 282 (Iowa 1997) (citations omitted).

61. *Iowa Glass Depot, Inc.*, 338 N.W.2d at 381 (citing Mut. Loan Co. v. Pierce, 65 N.W.2d 405, 408 (Iowa 1954)).

62. Pathology Consultants v. Gratton, 343 N.W.2d 428, 434 (Iowa 1984).

63. *See* Rasmussen Heating & Cooling, Inc. v. Idso, 463 N.W.2d 703, 704 (Iowa Ct. App. 1990) (stating that the range of enforceable covenants is generally between two and three years).

64. Sutton v. Iowa Trenchless, L.C., 808 N.W.2d 744, 750–51 (Iowa Ct. App. 2011) (holding that a seven-year covenant not to compete as part of sale of ownership of business was reasonable).

65. *See, e.g.*, Phone Connection, Inc. v. Harbst, 494 N.W.2d 445, 449–50 (Iowa Ct. App. 1992) (holding that a restrictive covenant lasting two years did not "pose an unnecessary or unreasonable hardship").

consider the following factors: (1) the amount of bargaining power, if any, the employee had to negotiate the specific terms of the covenant (e.g., whether the restrictive covenant was the product of an arm's-length transaction or simply presented to the employee on a take-it-or-leave-it basis); (2) what consideration, if any, the employee received in exchange for the restrictive covenant; (3) the nature of the employee's trade, profession, or industry, including the degree of employment mobility within that particular trade, profession, or industry; and (4) the employee's ability to obtain comparable employment that is consistent with the limitations contained in the restrictive covenant.[66] In addition, a reviewing court should look at whether the legitimate business interests the employer seeks to protect are adequately protected with a covenant of a shorter duration or through other measures that impinge less on the employee's rights and interests.

Iowa courts have been equally terse when determining whether the area restrictions contained in a restrictive covenant unduly restrict an employee's interests or are reasonably necessary to protect the business interest underlying the covenant. Although they have approved area restrictions encompassing six townships for two years,[67] twenty-five miles for three years,[68] and three counties for two years,[69] Iowa courts have not explained why those restrictions were reasonable or listed the specific factors considered in arriving at that determination.[70]

66. The analysis in *Sutton v. Iowa Trenchless, L.C.* is consistent with the factors listed above. In *Sutton*, the Iowa Court of Appeals overruled the lower court and held that a seven-year restrictive covenant ancillary to the purchase of a business was reasonable. 808 N.W.2d at 750. In its decision, the court stated that even though it applied the same analysis when reviewing "owner-to-owner" restrictive covenants as it applied when reviewing restrictive covenants ancillary to an employment relationship, restrictive covenants between business owners were entitled to "a greater scope of restraint" or to "more indulgence" than restrictive covenants between employers and employees. *Id.* at 749–50. According to the court, greater indulgence was owed to restrictive covenants between business owners largely because "when an owner sells his business, the parties involved are presumed to be in a more equal negotiating position than employers and employees." *Id.* at 749 (citing Brecher v. Brown, 17 N.W.2d 377, 379 (Iowa 1945)).

67. Farm Bureau Serv. Co. of Maynard v. Kohls, 203 N.W.2d 209, 212 (Iowa 1972).

68. Cogley Clinic v. Martini, 112 N.W.2d 678, 682–83 (Iowa 1962).

69. Federated Mut. Implement & Hardware Ins. Co. v. Erickson, 110 N.W.2d 264, 268 (Iowa 1961).

70. *See e.g.*, *id.*; *Farm Bureau Serv. Co.*, 203 N.W.2d at 212; *Cogley Clinic*, 112 N.W.2d at 682–83.

The economies of Iowa, and the nation, have expanded greatly since most of the cases cited above were decided, and area restrictions of six townships, ten miles, and three counties have become almost passé. Most restrictive covenants today are written far more broadly to include any state or even nation where the employer does business; thus, the restrictive covenants potentially have a global reach. However, covenants of unlimited reach arguably impinge on the employee's right to work and are invalid unless the employer can prove the covenants are necessary to protect a specific and compelling interest of the employer.[71]

To get around this problem, modern employers often omit area restrictions in the restrictive covenants they draft and, in their place, insert provisions that prohibit select employees from competing wherever the employer does business. The Iowa Court of Appeals approved this approach in *Sutton v. Iowa Trenchless, L.C.*,[72] in which the restrictive covenant at issue prohibited the former owner of Iowa Trenchless from competing with his former business for a period of seven years and within a 350-mile radius of Des Moines, Iowa—where Iowa Trenchless was located.[73] In approving the geographic area contained in the covenant, the court observed that the evidence offered at trial made it "clear [that] the 350-mile radius covered only those areas where Iowa Trenchless had performed work."[74] The court also observed that "historically, so long as the covenant was limited to the area where the business actually performed services, it was upheld even if the time restriction was unlimited."[75]

The Iowa Court of Appeals decision in *Iowa Trenchless* is somewhat unique in that it involved an owner-to-owner restrictive covenant negotiated as part of the sale of a business, and it is doubtful that Iowa courts would approve of a seven-year, 350-mile radius restrictive covenant

71. *See* RESTATEMENT (SECOND) OF CONTRACTS § 188 (1981) ("(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: . . . (b) a promise by an employee or other agent not to compete with his employer or other principal . . . .").

72. *See* Sutton v. Iowa Trenchless, L.C., 808 N.W.2d 744, 752 (Iowa Ct. App. 2011).

73. *Id.* at 747.

74. *Id.* at 751.

75. *Id.* (citations omitted).

within other contexts.[76] The Iowa Court of Appeals held in *Iowa Trenchless* that although the same factors applied when determining the enforceability of any restrictive covenant, "[a] much greater 'scope of restraint' is allowed between business owners."[77] Further, the defendant in *Iowa Trenchless* had a thirty percent ownership interest in the business before he sold his stock in the company, and he was one of two working partners.[78] It is doubtful that a restrictive covenant of like scope and duration could be reasonably applied to a former employee who signed the restrictive covenant as a condition to being hired and who never possessed an ownership interest in the business nor functioned in a capacity akin to a working partner.

Another less expansive approach modern employers deploy is to prohibit departing employees from competing within the employee's prior sales territory or from contacting any customer with whom the employee had contact during prior employment. Restrictive covenants of this nature are enforceable under Iowa law if the employer can establish the restriction was necessary to protect a legitimate interest of the employer.[79]

## IV. PUBLIC POLICY CONCERNS

To be enforceable, a restrictive covenant cannot be "prejudicial to the public interest."[80] Even though restrictive covenants are generally disfavored as a restraint of trade, Iowa courts have held that when "the basic contract is fair and equitable, such covenants do not violate public policy."[81] As a result, public policy concerns are typically not raised in restrictive covenant cases unless the case involves a physician or other health professional whose absence from a given market could endanger the public health.[82]

76. *See id.* at 747.

77. *Id.* at 749 (quoting Baker v. Starkey, 144 N.W.2d 889, 895 (Iowa 1966)).

78. *Id.* at 746.

79. Curtis 1000, Inc. v. Youngblade, 878 F. Supp. 1224, 1269 (N.D. Iowa 1995) (finding a covenant prohibiting an employee from having contact for two years with customers in his former sales territory with whom he previously had contact 0to be reasonable and enforceable); Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, 373 (Iowa 1971) (enforcing a covenant prohibiting a former employee from contacting any of the employer's customers for two years).

80. Revere Transducers, Inc. v. Deere & Co., 595 N.W.2d 751, 761 (Iowa 1999) (quoting Lamp v. Am. Prosthetics, Inc., 379 N.W.2d 909, 910 (Iowa 1986)).

81. Orkin Exterminating Co. v. Burnett, 146 N.W.2d 320, 324 (Iowa 1966).

82. The high hurdle litigants must overcome to demonstrate that a restrictive covenant involving purely commercial interest is unreasonably restrictive is evident in *Sutton*, in which the Iowa Court of Appeals concluded that a seven-year restrictive

For example, in *Board of Regents v. Warren*, a doctor who was formerly employed as an assistant professor at the University of Iowa College of Medicine argued, and the lower court ultimately found, that a restrictive covenant prohibiting the doctor from practicing medicine in any community in which he previously practiced[83] violated public policy and was not enforceable.[84] In support of that argument, Dr. Warren, who specialized in treating cancer patients, pointed out that the federal government had designated Cedar Rapids, the community in which he sought to practice, "as underserved by physicians," and noted that Cedar Rapids "would be negatively impacted if [he] were not permitted to treat cancer patients there."[85] The Iowa Court of Appeals agreed with Dr. Warren, concluding that the public interest "for appropriate and sufficient health care" weighed in favor of not enforcing the restrictive covenant.[86]

The Court of Appeals decision in *Warren* is somewhat at odds with *Cogley Clinic v. Martini*,[87] a case decided forty-six years before *Warren*. In *Cogley Clinic*, the Iowa Supreme Court rejected arguments very similar to those advanced in *Warren*[88] and enforced a restrictive covenant that prohibited a physician from practicing medicine within twenty-five miles of Council Bluffs for three years.[89] The court in *Warren* distinguished *Cogley* by noting that the Iowa Supreme Court "considered the great number of doctors practicing in Council Bluffs and Omaha, and concluded, [t]he public welfare is not seriously involved in this case."[90] According to the Iowa Court of Appeals in *Warren*, a different result was warranted because, in contrast to the physician in *Cogley*, "Dr. Warren presented testimony that the federal government had designated Cedar Rapids as underserved by physicians, and the visa quota for the area had been

covenant between the current and former owners of a construction business did not harm the public interest because the "covenant did not result in a monopoly or even in the reduction in the number of companies that do trenchless construction. It simply prevented a new company from entering the marketplace." *Sutton*, 808 N.W.2d at 752.

83. Bd. of Regents v. Warren, No. 08-0017, 2008 WL 5003750, *1 (Iowa Ct. App. Nov. 26, 2008).

84. *Id.* at *5–6.

85. *Id.* at *5.

86. *Id.* at *6.

87. Cogley Clinic v. Martini, 112 N.W.2d 678 (Iowa 1962).

88. *Id.* at 682.

89. *Id.* at 680.

90. *Warren*, 2008 WL 5003750, at *5 (quoting *Cogley Clinic*, 112 N.W.2d at 682) (internal quotation marks omitted).

increased."[91] Based on those facts, the *Warren* court concluded that the public interest would be adversely served if the restrictive covenant was enforced.[92]

The opinions in *Warren* and *Cogley* suggest that, all other factors being equal, Iowa courts may refuse to enforce restrictive covenants against a physician if the community in question is either generally underserved by physicians or if it lacks doctors who practice in a certain specialty or practice area.[93] Whether Iowa courts will be willing to apply this same logic to other licensed professions within or outside the healthcare industry is difficult to predict. Further, public policy concerns are typically not at issue in cases involving employees outside the learned professions.

## V. A NEW APPROACH GOING FORWARD

The primary problem with Iowa law regarding the enforcement of restrictive covenants is uncertainty. Current Iowa law on this topic includes too many factors, and has too many moving parts, all of which leave both employers and employees in a quandary regarding whether a given court, on a given day, will enforce the restrictive covenants they sign and, if so, to what extent. A consistent rule applied to all restrictive covenants would eliminate the uncertainty that pervades Iowa's restrictive covenant jurisprudence.

An approach that Iowa courts should consider adopting going forward is the approach the Nebraska Supreme Court adopted in *Polly v. Ray D. Hilderman & Co.*[94] In *Polly*, the court applied standards very similar to those that Iowa courts have applied in the past, and the Nebraska court concluded that a covenant not to compete contained in an employment contract is "valid only if it restricts the former employee from working for or soliciting the former employer's clients or accounts with whom the former employee actually did business and has personal contact."[95] Applying this rule, the court struck down a restrictive covenant that prevented Polly, an accountant, from being employed by any of Hilderman's clients who lived within thirty-five miles of any of Hilderman's

91. *Id.*
92. *Id.*
93. *See Cogley Clinic*, 112 N.W.2d at 680; *Warren*, 2008 WL 5003750, at *2.
94. Polly v. Ray D. Hilderman & Co., 407 N.W.2d 751 (Neb. 1987).
95. *Id.* at 756.

three offices for a period of three years.[96] Because the covenant "included clients with whom Polly did not work and did not even know," it was not, according to the Nebraska court, "reasonably necessary to protect Hilderman's legitimate interest in customer goodwill and [wa]s thus unreasonable and unenforceable."[97]

The rule stated in *Polly* is premised on the assumption that covenants not to compete are put in place primarily to prevent employees from using information they obtained or from taking advantage of relationships they developed during their employment to compete with their former employer.[98] Nebraska courts found that interest is adequately protected by a covenant that "restricts the former employee from soliciting or working for clients" or accounts "with whom the former employee actually had contact" during their prior employment.[99] In cases decided after *Polly*, "Nebraska courts have narrowly defined the permissible scope of covenants not to compete contained in employment agreements to include only this form of 'customer specific' restraint."[100]

The "customer specific restraint" approach Nebraska has followed is arguably preferable to the ad hoc approach Iowa courts follow primarily because it is simple and predictable.[101] As a result of the approach established in Nebraska, both employers and employees know from the outset that courts in their state will only enforce restrictive covenants to the extent the covenant is consistent with the standard articulated in *Polly*, and no further.[102] Moreover, the Nebraska standard adequately protects the employer's primary interest in having employees sign covenants not to compete—preventing former employees from pirating customers—while, at the same time, the standard does not significantly impede the former employee's right to continue working in a chosen field or occupation.

The obvious downsides of the "customer specific restraint" approach are that it limits the party's freedom to contract and that it effectively converts all restrictive covenants to agreements prohibiting future

96. *Id.*
97. *Id.*
98. *Id.*
99. Softchoice Corp. v. MacKenzie, 636 F. Supp. 2d 927, 938 (D. Neb. 2009) (citing Mertz v. Pharmacists Mut. Ins. Co., 625 N.W.2d 197, 204–05 (Neb. 2001)).
100. *Id.* (quoting Presto-X-Co. v. Beller, 568 N.W.2d 235 (Neb. 1997)).
101. *Id.* (quoting *Presto-X-Co.*, 568 N.W.2d at 235) (internal quotation marks omitted).
102. *See Polly*, 407 N.W.2d at 756.

solicitation of clients and customers, which may or may not adequately protect all of the employer's legitimate interests.[103] For example, the Nebraska approach arguably protects an employer's interest in preventing former sales representatives from pirating customers and business, but does little or nothing to prevent former engineers and research and design professionals from taking any specialized know-how they acquire during their employment to benefit a competitor.[104] Though trade secret law provides employers with some comfort in that regard, an argument can be made that only a specific agreement preventing employees from accepting work with a direct competitor for a given period of time adequately protects the employer's interest in keeping its methods, strategies, and other sensitive information secret.

This Author believes the pros far outweigh the cons, and Iowa courts should consider following Nebraska's lead by adopting an equally balanced and predictable position in future restrictive covenant cases. If adopted in Iowa, the Nebraska approach would eliminate much of the uncertainty and lack of productivity that surrounds Iowa's current restrictive covenant law. Further, this approach would prevent employers from using the clear advantage they have at the inception of the employment relationship to extract career-altering concessions from newly hired employees. The Nebraska approach would not, however, offer much solace to the successful stockbroker seeking to flip his book of business.

103. *See Softchoice Corp.*, 636 F. Supp. 2d at 938.
104. *See id.*