Contracts—UNLESS THE FACTS AND CIRCUMSTANCES INDICATE BAD FAITH ON THE PART OF THE EMPLOYER, THE COURT WILL ENFORCE NON-COMPETITIVE COVENANTS TO THE EXTENT THEY ARE REASONABLY NECESSARY TO PROTECT THE LEGITIMATE INTERESTS OF THE EMPLOYER WITHOUT IMPOSING UNDUE HARDSHIP ON THE EMPLOYEE WHEN THE PUBLIC INTEREST IS NOT ADVERSELY AFFECTED.—*Ehlers v. Iowa Warehouse Co.* (Iowa 1971).

Plaintiff-employee entered into an employment contract with defendant-employer which contained two noncompetitive covenants. The first covenant prohibited plaintiff from disclosing his compiled list of defendant's customers to any third party or using it directly or indirectly in a competitive business after the termination of his employment. No time limit was stated within the contract. The second covenant prohibited plaintiff from entering into a competitive business within 150 miles of the defendant's business location for a period of two years. Plaintiff sought a declaratory judgment rendering both covenants void and unenforceable. Defendant's counterclaim for injunctive relief was granted. The Iowa supreme court with two justices dissenting *held*, modified, affirmed and remanded. Unless the facts and circumstances indicate bad faith on the part of the employer, the court will enforce noncompetitive covenants to the extent they are reasonably necessary to protect the legitimate interest of the employer without imposing undue hardship on the employee when the public interest is not adversely affected. *Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d 368 (Iowa 1971).

Since *Brecher v. Brown*,[1] it has been well established in Iowa that a covenant within an employment contract cannot be upheld in part and rejected in part. The covenant in *Brecher* forbade the employee from competing in the practice of veterinary medicine within a twenty-five mile radius of his employer's business after his employment terminated. The covenant did not have a time limit and was, therefore, not reasonably limited to the protection of the employer's interests. Furthermore, the covenant was found to impose undue hardship on the employee and to be against public policy. The court would not partially enforce the covenant. Instead they adopted a more arbitrary "all or nothing rule."—If the entire covenant was reasonable it would be enforced, otherwise it would be entirely rejected. In a more recent decision,[2] however, the Iowa court recognized the merits of a partial enforcement rule but declined to adopt it.[3] Rather, the court chose to adopt the void per se rule as expressed by the New Jersey supreme court in *Hudson Foam Latex Products, Inc. v. Aiken*.[4] The New Jersey supreme court, however, has chosen to replace this doctrine with a partial enforcement rule in *Solari*

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[1] 235 Iowa 627, 17 N.W.2d 377 (1945).

[2] Baker v. Starkey, 259 Iowa 480, 492-95, 144 N.W.2d 889, 897-98 (1966).

[3] *See* Note, *An Employer's Competitive Restraints on Former Employees*, 17 DRAKE L. REV. 69, 71 (1967).

[4] Hudson Foam Latex Products, Inc. v. Aiken, 82 N.J. Super. 508, 198 A.2d 136 (App. Div. 1964).

Industries, Inc. v. Malady.[5] The Iowa supreme court in *Ehlers* also adopted the partial enforcement rule established in *Solari*.

In *Ehlers*, the court overruled *Brecher* and adopted a new rule allowing partial enforcement of a noncompetitive agreement to the extent that it is reasonably necessary to protect the employer's legitimate interests without imposing undue hardship on the employee when the public interest is not adversely affected and there is no showing of bad faith on the part of the employer. In applying the new rule to the facts and circumstances in *Ehlers*,[6] the court reiterated the prerequisites to the enforcement of a noncompetitive covenant. The employer has the burden to show that when the employee left his employment, he took or had an opportunity to take some part of the good will of the business, or that it can reasonably be expected that some of the employer's customers will follow the employee to his new business.[7] The employer met the burden by demonstrating that the plaintiff had received oral commitments from employer's customers to do business with him should he start a business of his own. Equally as important was the fact that at the time of trial, the plaintiff was doing business with one of his former employer's customers under an agreement reached while the plaintiff was still in the employ of the defendant.[8]

To what extent a noncompetitive covenant will be enforced depends largely on the balancing of the protection to be afforded an employer from the departing employee's advantageous position and the undue hardship imposed on the departing employee who wishes to engage in a similar business. Under the partial enforcement rule the covenant will be enforced to an extent necessary to balance the interests of both parties. In *Ehlers*, the employer's business extended beyond the 150 mile radius referred to in the covenant. There were also many population centers within the radius not served by the employer which had potential customers. Therefore, it seemed in the interest of both parties to limit the restriction to only those customers that the employee had dealt with while in the employ of the defendant. The two year restriction in the covenant was found to be a reasonable time for the employer to establish an independent business relationship with the customers who were accustomed to dealing with the plaintiff.[9] The partial enforcement rule also requires that the public interest be protected. That interest includes a policy against restraints on competition and trade.[10] Partial enforcement did not violate that policy in *Ehlers* because there was still a good deal of competition in the particular business despite the fact that plaintiff's ability to compete was limited.[11]

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5 Solari Industries, Inc. v. Malady, 55 N.J. 571, 264 A.2d 53, 56 (1970).
6 Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, 373 (Iowa 1971).
7 Mutual Loan Co. v. Pierce, 245 Iowa 1051, 1056-57, 65 N.W.2d 405, 408 (1954).
8 Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, 373 (Iowa 1971).
9 *Id.*; *See generally* Annot., 41 A.L.R.2d 15 (1955); Annot., 43 A.L.R.2d 94 (1955).
10 *Id.* at 376.
11 *Id.* at 373.

While the "all or nothing" approach of *Hudson Foam* has been rejected, the Iowa court has chosen to retain the good faith requirements as set forth in *Hudson Foam* and *Starkey*.[12] A lack of good faith may be established by showing that the employer took an unconscionable advantage of the employee or that the covenant is so broad as to constitute bad faith.[13] If it can be shown by credible evidence that such a covenant was intentionally made unreasonable and oppressive it will be held to be invalid whether severable or not.[14] However, equity will not allow the injustice that might result should the court find a covenant void per se solely on the basis that it differs with the employer's opinion as to what is reasonably necessary to protect his interests.[15]

The goal of the courts in cases involving noncompetitive covenants is to promote equity between the parties and the public. As the court points out in *Ehlers*, the "all or nothing" rule has led to results of questionable equity.[16] For example, a covenant prohibiting an orthopedic surgeon from practicing within an area composed of over 450,000 people for a period of three years has been held to be reasonable.[17] The result of striking down the covenant in *Brecher* in its entirety was to allow a veterinary to establish his practice within 100 feet of his former employer. Also, the New Jersey supreme court has recognized[18] that judges have upheld or stricken noncompetitive agreements that they otherwise might have enforced to a limited degree if they had had the power to do so.

Some jurisdictions have sought to avoid the inequitable results of the "all or nothing" rule by using what is known as the "blue pencil rule." This rule allows the partial enforcement of a covenant if the unreasonable terms can be stricken leaving a meaningful restriction.[19] However, when the employer in good faith drafts a noncompetitive covenant that is too broad to be enforceable courts are increasingly applying the partial enforcement rule[20] as advocated by Williston[21] and Corbin.[22]

The dissenting opinion in *Ehlers* raises several criticisms worthy of dis-

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12 188 N.W.2d at 374.
13 *Id.*
14 Fullerton Lumber Co. v. Torborg, 270 Wis. 133, 70 N.W.2d 585, 592 (1955).
15 Ehlers v. Iowa Warehouse Co., 188 N.W.2d 368, 374 (Iowa 1971).
16 *Id.* at 371.
17 Cogley Clinic v. Martini, 253 Iowa 541, 112 N.W.2d 678 (1962).
18 Solari Industries, Inc. v. Malady, 55 N.J. 571, 573, 264 A.2d 53, 60 (1970).
19 Wood v. May, 73 Wash. 2d 307, 308, 438 P.2d 587, 590-91 (1968).
20 *See* Credit Bureau Management Co. v. Huie, 254 F. Supp. 547 (W.D. Ark., 1966;) Ebbeskotte v. Tyler, 127 Ind. App. 433, 142 N.E.2d 905 (1957); Redd Pest Control Co. v. Heatherly, 248 Miss. 34, 157 So. 2d 133 (1963); Wood v. May, 73 Wash. 2d 307, 438 P.2d 587 (1968); Fullerton Lumber Co. v. Torborg, 270 Wis. 133, 70 N.W.2d 585 (1955); *See generally* 17 C.J.S. Contracts § 289 (1963); *cf.* John Roane, Inc. v. Tweed, 33 Del. Ch. 4, 89 A.2d 548 (1952); Cedric G. Chase Photo Lab. v. Hennessey, 327 Mass. 137, 97 N.E.2d 397 (1951); Plunkett Chemical Co. v. Reeve, 373 Pa. 513, 95 A.2d 925 (1953); Ramey v. Combined American Ins. Co., 359 S.W.2d 523 (Tex. Civ. App. 1962); Denny v. Roth, 296 S.W.2d 944 (Tex. Civ. App. 1956); *but cf.* Extine v. Williamson Midwest, Inc., 176 Ohio 403, 200 N.E.2d 297 (1964).
21 5 S. WILLISTON, CONTRACTS, §§ 1659, 60 (rev. ed. 1937).
22 6A A. CORBIN, CONTRACTS, § 1390, at 70-71 (1962).

cussion. It points out that while the majority decision specifically overrules *Brecher*, it also in effect overrules other cases rejecting the adoption of the partial enforcement doctrine. One such case involves a noncompetitive covenant within a business sale contract.[23] The majority did not state whether it intended the new rule to apply to business sale contracts as well as employment contracts, but it did recognize a distinction between the two agreements.[24] However, the dissent suggests that the reasons for adopting the partial enforcement rule are more convincing in the case of a business sale contract and that, therefore, the former should be included within the scope of the rule.[25]

Another criticism leveled by the dissenters at the adoption of the partial enforcement doctrine is that it violates the well established rule in contract law that the courts will honor the intention of the parties entering into an agreement[26] and not make the contract for them.[27] The dissent in rather strong language states: "*The courts, rather than the bargaining parties, will decide what is reasonable and interpret the contract as though the covenant now reads as the court thinks it should read.*"[28] The majority addresses itself to this important issue. In their opinion partial enforcement is not making a new contract but rather a choice among the possible effects of the agreement reached by the parties. The choice made is the one most desirable for the parties involved and the public interest. Furthermore, partial enforcement involves much less deviation from the effects intended by the parties than total non-enforcement would.[29]

The arbitrary "all or nothing" rule has led to many inequitable results in the past. In the future, unless the facts and circumstances indicate bad faith on the part of the employer, the court will enforce noncompetitive covenants to the extent they are reasonably necessary to protect the legitimate interests of the employer without imposing undue hardship on the employee when the public interest is not adversely affected. Whether the rule will be expanded to include noncompetitive covenants within a business sale contract is an issue for future resolution.

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23 Kunz v. Bock, 163 N.W.2d 442, 446 (Iowa 1968).
24 188 N.W.2d at 369; *See also* Annot., 45 A.L.R.2d 77 (1955); Annot., 46 A.L.R. 2d 119 (1955).
25 188 N.W.2d at 375.
26 Hamilton v. Wosepka, 261 Iowa 299, 306, 154 N.W.2d 164, 168 (1967).
27 Smith v. Stowell, 256 Iowa 165, 170-72, 125 N.W.2d 795, 798-99 (1964).
28 188 N.W.2d at 377.
29 *Id.* at 374.