

Restatement (Second) of Contracts § 178 (1981)
§ 178. When A Term Is Unenforceable On Grounds Of Public Policy

(1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.

(2) In weighing the interest in the enforcement of a term, account is taken of

(a) the parties' justified expectations,

(b) any forfeiture that would result if enforcement were denied, and

(c) any special public interest in the enforcement of the particular term.

(3) In weighing a public policy against enforcement of a term, account is taken of

(a) the strength of that policy as manifested by legislation or judicial decisions,

(b) the likelihood that a refusal to enforce the term will further that policy,

(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and

(d) the directness of the connection between that misconduct and the term.

Comment:

a. Legislation providing for unenforceability. Occasionally, on grounds of public policy, legislation provides that specified kinds of promises or other terms are unenforceable. Whether such legislation is valid and applicable to the particular term in dispute is beyond the scope of this Restatement. Assuming that it is, the court is bound to carry out the legislative mandate with respect to the enforceability of the term. But with respect to such other matters as the enforceability of the rest of the agreement (§§ 183, 184) and the possibility of restitution (Topic 5), a court will be guided by the same rules that apply to other terms unenforceable on grounds of public policy (see Illustration 1), absent contrary provision in the legislation itself (see Illustration 3). The term "legislation" is used here in the broadest sense to include any fixed text enacted by a body with authority to promulgate rules, including not only statutes, but constitutions and local ordinances, as well as administrative regulations issued pursuant to them. It also encompasses foreign laws to the extent that they are applicable under conflict of laws rules. See Restatement, Second, Conflict of Laws §§ 202, 203.

Illustrations:

1. A promises to pay B \$1,000 if the Buckets win their basketball game with the Hoops, and B promises to pay A \$2,000 if the Hoops win. A state statute makes wagering a crime and provides that a promise such as A's or B's is "void." A's and B's promises are unenforceable on grounds of public policy. Any claims of A or B to restitution for money paid under the agreement are governed by the rules stated in Topic 5. See § 199(b) and Illustrations 4 and 5 to that section.

2. A and B make an agreement by which A agrees to sell and B to buy, at a fixed price per bushel, one thousand bushels of wheat from A at any time that A shall choose during the following month. The state statute that makes wagering a crime does not apply to such an agreement and it does not offend any judicially declared public policy. Enforcement of A's and B's promises is not precluded on grounds of public policy.

3. A borrows \$10,000 from the B Bank, promising to repay it with interest at the rate of twelve per cent. A state statute that fixes the maximum legal rate of interest on such loans at ten per cent provides that a promise to pay a greater sum is "void" as usurious as to all the promised interest but not as to the principal. A's promise to pay the interest is unenforceable on grounds of public policy. The rule stated in § 184(2) does not make A's promise to pay interest

enforceable up to ten per cent because the legislation provides otherwise. Compare Illustration 5 to § 184.

b. Balancing of interests. Only infrequently does legislation, on grounds of public policy, provide that a term is unenforceable. When a court reaches that conclusion, it usually does so on the basis of a public policy derived either from its own perception of the need to protect some aspect of the public welfare or from legislation that is relevant to that policy although it says nothing explicitly about unenforceability. See § 179. In some cases the contravention of public policy is so grave, as when an agreement involves a serious crime or tort, that unenforceability is plain. In other cases the contravention is so trivial as that it plainly does not preclude enforcement. In doubtful cases, however, a decision as to enforceability is reached only after a careful balancing, in the light of all the circumstances, of the interest in the enforcement of the particular promise against the policy against the enforcement of such terms. The most common factors in the balancing process are set out in Subsections (2) and (3). Enforcement will be denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in the enforcement of the particular term.

c. Strength of policy. The strength of the public policy involved is a critical factor in the balancing process. Even when the policy is one manifested by legislation, it may be too insubstantial to outweigh the interest in the enforcement of the term in question. See Illustrations 4 and 5. A court should be particularly alert to this possibility in the case of minor administrative regulations or local ordinances that may not be indicative of the general welfare. A disparity between a relatively modest criminal sanction provided by the legislature and a much larger forfeiture that will result if enforcement of the promise is refused may suggest that the policy is not substantial enough to justify the refusal. See Illustration 4.

Illustrations:

4. A and B make an agreement for the sale of goods for \$10,000, in which A promises to deliver the goods in his own truck at a designated time and place. A municipal parking ordinance makes unloading of a truck at that time and place an offense punishable by a fine of up to \$50. A delivers the goods to B as provided. Because the public policy manifested by the ordinance is not sufficiently substantial to outweigh the interest in the enforcement of B's promise, enforcement of his promise is not precluded on grounds of public policy.

5. A promises to employ B and B promises to work for A, all work to be done on weekdays. The agreement is made on Sunday in violation of a statute that makes the doing of business on Sunday a misdemeanor. If the court decides that the public policy manifested by the statute is not sufficiently substantial to outweigh the interests in enforcement of A's and B's promises, it will hold that enforcement of their promises is not precluded on grounds of public policy. ...

111 S.Ct. 2513

Supreme Court of the United States
COHEN v. COWLES MEDIA CO
Decided June 24, 1991.

Justice WHITE delivered the opinion of the Court.

The question before us is whether the First Amendment prohibits a plaintiff from recovering damages, under state promissory estoppel law, for a newspaper's breach of a promise of confidentiality given to the plaintiff in exchange for information. We hold

that it does not.

During the closing days of the 1982 Minnesota gubernatorial race, Dan Cohen, an active Republican associated with Wheelock Whitney's Independent-Republican gubernatorial campaign, approached reporters from the St. Paul Pioneer Press Dispatch (Pioneer Press) and the Minneapolis Star and Tribune (Star Tribune) and offered to provide documents relating to a candidate in the upcoming election. Cohen made clear to the reporters that he would provide the information only if he was given a promise of confidentiality. Reporters from both papers promised to keep Cohen's identity anonymous and Cohen turned over copies of two public court records concerning Marlene Johnson, the Democratic-Farmer-Labor candidate for Lieutenant Governor. The first record indicated that Johnson had been charged in 1969 with three counts of unlawful assembly, and the second that she had been convicted in 1970 of petit theft. Both newspapers interviewed Johnson for her explanation and one reporter tracked down the person who had found the records for Cohen. As it turned out, the unlawful assembly charges arose out of Johnson's participation in a protest of an alleged failure to hire minority workers on municipal construction projects, and the charges were eventually dismissed. The petit theft conviction was for leaving a store without paying *666 for \$6 worth of sewing materials. The incident apparently occurred at a time during which Johnson was emotionally distraught, and the conviction was later vacated.

After consultation and debate, the editorial staffs of the two newspapers independently decided to publish Cohen's name as part of their stories concerning Johnson. In their stories, both papers identified Cohen as the source of the court records, indicated his connection to the Whitney campaign, and included denials by Whitney campaign officials of any role in the matter. The same day the stories appeared, Cohen was fired by his employer.

Cohen sued respondents, the publishers of the Pioneer Press and Star Tribune, in Minnesota state court, alleging fraudulent misrepresentation and breach of contract. The trial court rejected respondents' argument that the First Amendment barred Cohen's lawsuit. A jury returned a verdict in Cohen's favor, awarding him \$200,000 in compensatory damages and \$500,000 in punitive damages. The Minnesota Court of Appeals, in a split decision, reversed the award of punitive damages after concluding that Cohen had failed to establish a fraud claim, the only claim which would support such an award. 445 N.W.2d 248, 260 (1989). However, the court upheld the finding of liability for breach of contract and the \$200,000 compensatory damages award. *Id.*, at 262.

A divided Minnesota Supreme Court reversed the compensatory damages award. 457 N.W.2d 199 (1990). After affirming the Court of Appeals' determination that Cohen had not established a claim for fraudulent misrepresentation, the court considered his breach-of-contract claim and concluded that "a contract cause of action is inappropriate **2517 for these particular circumstances." *Id.*, at 203. The court then went on to address the question whether Cohen could establish a cause of action under Minnesota law on a promissory estoppel theory. Apparently, a promissory estoppel theory was

never tried to the jury, nor briefed nor argued by *667 the parties; it first arose during oral argument in the Minnesota Supreme Court when one of the justices asked a question about equitable estoppel. See App. 38.

In addressing the promissory estoppel question, the court decided that the most problematic element in establishing such a cause of action here was whether injustice could be avoided only by enforcing the promise of confidentiality made to Cohen. The court stated: "Under a promissory estoppel analysis there can be no neutrality towards the First Amendment. In deciding whether it would be unjust not to enforce the promise, the court must necessarily weigh the same considerations that are weighed for whether the First Amendment has been violated. The court must balance the constitutional rights of a free press against the common law interest in protecting a promise of anonymity." 457 N.W.2d, at 205. After a brief discussion, the court concluded that "in this case enforcement of the promise of confidentiality under a promissory estoppel theory would violate defendants' First Amendment rights." *Ibid.*...

The initial question we face is whether a private cause of action for promissory estoppel involves "state action" within the meaning of the Fourteenth Amendment such that the protections of the First Amendment are triggered. For if it does not, then the First Amendment has no bearing on this case. The rationale of our decision in *New York Times Co. v. Sullivan*, 376 U.S. 254, 84 S.Ct. 710, 11 L.Ed.2d 686 (1964), and subsequent cases compels the conclusion that there is state action here. Our cases teach that the application of state rules of law in state courts in a manner alleged to restrict First Amendment freedoms constitutes "state action" under the Fourteenth Amendment. See, e.g., *id.*, at 265, 84 S.Ct., at 718; *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886, 916, n. 51, 102 S.Ct. 3409, 3427, n. 51, 73 L.Ed.2d 1215 (1982); *Philadelphia Newspapers, Inc. v. Hepps*, 475 U.S. 767, 777, 106 S.Ct. 1558, 1564, 89 L.Ed.2d 783 (1986). In this case, the Minnesota Supreme Court held that if Cohen could recover at all it would be on the theory of promissory estoppel, a state-law doctrine which, in the absence of a contract, creates obligations never explicitly assumed by the parties. These legal obligations would be enforced through the official power of the Minnesota courts. Under our cases, that is enough to constitute "state action" for purposes of the Fourteenth Amendment.

Respondents rely on the proposition that "if a newspaper lawfully obtains truthful information about a matter of public significance then state officials may not constitutionally punish publication of the information, absent a need to further a *669 state interest of the highest order." *Smith v. Daily Mail Publishing Co.*, 443 U.S. 97, 103, 99 S.Ct. 2667, 2671, 61 L.Ed.2d 399 (1979). That proposition is unexceptionable, and it has been applied in various cases that have found insufficient the asserted state interests in preventing publication of truthful, lawfully obtained information. See, e.g., *Florida Star v. B.J.F.*, 491 U.S. 524, 109 S.Ct. 2603, 105 L.Ed.2d 443 (1989); *Smith v. Daily Mail*, *supra*; *Landmark Communications, Inc. v. Virginia*, 435 U.S. 829, 98 S.Ct. 1535, 56 L.Ed.2d 1 (1978).

This case, however, is not controlled by this line of cases but, rather, by the equally well-established line of decisions holding that generally applicable laws do not offend the First Amendment simply because their enforcement against the press has incidental effects on its ability to gather and report the news. As the cases relied on by

respondents recognize, the truthful information sought to be published must have been lawfully acquired. The press may not with impunity break and enter an office or dwelling to gather news. Neither does the First Amendment relieve a newspaper reporter of the obligation shared by all citizens to respond to a grand jury subpoena and answer questions relevant to a criminal investigation, even though the reporter might be required to reveal a confidential source. *Branzburg v. Hayes*, 408 U.S. 665, 92 S.Ct. 2646, 33 L.Ed.2d 626 (1972). The press, like others interested in publishing, may not publish copyrighted material without obeying the copyright laws. See *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 576-579, 97 S.Ct. 2849, 2857-2859, 53 L.Ed.2d 965 (1977). Similarly, the media must obey the National Labor Relations Act, *Associated Press v. NLRB*, 301 U.S. 103, 57 S.Ct. 650, 81 L.Ed. 953 (1937), and the Fair Labor Standards Act, *Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186, 192-193, 66 S.Ct. 494, 497, 90 L.Ed. 614 (1946); may not restrain trade in violation of the antitrust laws, *Associated Press v. United States*, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013 (1945); *Citizen Publishing Co. v. United States*, 394 U.S. 131, 139, 89 S.Ct. 927, 931, 22 L.Ed.2d 148 (1969); and must pay non-discriminatory taxes, *Murdock v. Pennsylvania*, 319 U.S. 105, 112, 63 S.Ct. 870, 874, 87 L.Ed. 1292 (1943); *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 581-583, 103 S.Ct. 1365, 1369-1371, 75 L.Ed.2d 295 (1983). *670 Cf. *University of Pennsylvania v. EEOC*, 493 U.S. 182, 201-202, 110 S.Ct. 577, 588-589, 107 L.Ed.2d 571 (1990). It is, therefore, beyond dispute that "[t]he publisher of a newspaper has no special immunity from the application of general laws. He has no special privilege to invade the rights and liberties of others." *Associated Press v. NLRB*, *supra*, 301 U.S., at 132-133, 57 S.Ct., at 655-656. Accordingly, enforcement of such general laws against the press is not subject to stricter scrutiny than would be applied to enforcement against other persons or organizations.

There can be little doubt that the Minnesota doctrine of promissory estoppel is a law of general applicability. It does not target or single out the press. Rather, insofar as we are advised, the doctrine is generally applicable to the daily transactions of all the citizens **2519 of Minnesota. The First Amendment does not forbid its application to the press.

Justice BLACKMUN suggests that applying Minnesota promissory estoppel doctrine in this case will "punish" respondents for publishing truthful information that was lawfully obtained. *Post*, at 2521-2522. This is not strictly accurate because compensatory damages are not a form of punishment, as were the criminal sanctions at issue in *Smith v. Daily Mail*, *supra*. If the contract between the parties in this case had contained a liquidated damages provision, it would be perfectly clear that the payment to petitioner would represent a cost of acquiring newsworthy material to be published at a profit, rather than a punishment imposed by the State. The payment of compensatory damages in this case is constitutionally indistinguishable from a generous bonus paid to a confidential news source. In any event, as indicated above, the characterization of the payment makes no difference for First Amendment purposes when the law being applied is a general law and does not single out the press. Moreover, Justice BLACKMUN's reliance on cases like *Florida Star v. B.J.F.*, *supra*, and *Smith v. Daily Mail* is misplaced. In those cases, the State itself defined the content of publications that would trigger liability. Here, by contrast, *671 Minnesota law simply

requires those making promises to keep them. The parties themselves, as in this case, determine the scope of their legal obligations, and any restrictions that may be placed on the publication of truthful information are self-imposed.

Also, it is not at all clear that respondents obtained Cohen's name "lawfully" in this case, at least for purposes of publishing it. Unlike the situation in *Florida Star*, where the rape victim's name was obtained through lawful access to a police report, respondents obtained Cohen's name only by making a promise that they did not honor. The dissenting opinions suggest that the press should not be subject to any law, including copyright law for example, which in any fashion or to any degree limits or restricts the press' right to report truthful information. The First Amendment does not grant the press such limitless protection.

Nor is Cohen attempting to use a promissory estoppel cause of action to avoid the strict requirements for establishing a libel or defamation claim. As the Minnesota Supreme Court observed here, "Cohen could not sue for defamation because the information disclosed [his name] was true." 457 N.W.2d, at 202. Cohen is not seeking damages for injury to his reputation or his state of mind. He sought damages in excess of \$50,000 for breach of a promise that caused him to lose his job and lowered his earning capacity. Thus, this is not a case like *Hustler Magazine, Inc. v. Falwell*, 485 U.S. 46, 108 S.Ct. 876, 99 L.Ed.2d 41 (1988), where we held that the constitutional libel standards apply to a claim alleging that the publication of a parody was a state-law tort of intentional infliction of emotional distress.

Respondents and *amici* argue that permitting Cohen to maintain a cause of action for promissory estoppel will inhibit truthful reporting because news organizations will have legal incentives not to disclose a confidential source's identity even when that person's identity is itself newsworthy. Justice SOUTER makes a similar argument. But if this is the case, *672 it is no more than the incidental, and constitutionally insignificant, consequence of applying to the press a generally applicable law that requires those who make certain kinds of promises to keep them. Although we conclude that the First Amendment does not confer on the press a constitutional right to disregard promises that would otherwise be enforced under state law, we reject Cohen's request that in reversing the Minnesota Supreme Court's judgment we reinstate the jury verdict awarding him \$200,000 in compensatory damages. See Brief for Petitioner 31. The Minnesota Supreme Court's incorrect conclusion that the First Amendment barred Cohen's claim may **2520 well have truncated its consideration of whether a promissory estoppel claim had otherwise been established under Minnesota law and whether Cohen's jury verdict could be upheld on a promissory estoppel basis. Or perhaps the State Constitution may be construed to shield the press from a promissory estoppel cause of action such as this one. These are matters for the Minnesota Supreme Court to address and resolve in the first instance on remand. Accordingly, the judgment of the Minnesota Supreme Court is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

So ordered.

725 S.W.2d 168
Supreme Court of Texas.
HILL v. MOBILE AUTO TRIM, INC.

Jan. 28, 1987.

KILGARLIN, Justice.

Based on a covenant not to compete in a franchise agreement, Mobile Auto Trim, Inc. sought to enjoin Joel Hill, a former franchisee, from competing with it in a seven-county area. The trial court granted the temporary injunction. The court of appeals, with one justice dissenting, affirmed the temporary injunction. In a single point of error, Hill complains that the non-competition agreement is a restraint on trade and is unreasonable. We agree and therefore reverse the judgment of the court of appeals, dissolve the temporary injunction, and hold the restrictive covenant in the franchise agreement void in all respects.

Mobile Auto Trim sells car trim franchises in which equipped vans are driven to car dealerships to make repairs at the premises. In August 1982, Mobile sold a franchise to Joel Hill for approximately \$42,000 plus five percent of his gross revenues. Hill's franchise covered a large part of Dallas County and all of Denton County. The franchise agreement contained this covenant not to compete:

Franchisee (Hill) agrees that upon termination of this Franchise Agreement, for whatever reason, Franchisee shall not directly or indirectly, as an officer, director, shareholder, proprietor, partner, consultant, employee or in any other individual or representative capacity, engage, participate or become involved in any business that is in competition in any manner whatsoever with the business of the Company or its franchisees. Furthermore it is understood between the parties that substantial goodwill will exist between the Company and the managers of the various car dealerships serviced by the Company and the Company's franchisees. Because said managers are transient and frequently change employment among car dealerships, Franchisee further agrees that upon termination of this Franchise Agreement, for whatever reason, Franchisee will not directly or indirectly in any manner whatsoever, in any capacity whatsoever, contact said managers (irrespective of the car dealerships that employ them) regarding business in competition with the Company. This covenant shall extend for a period of three (3) years following the termination of this Franchise Agreement or any renewal hereof. Further, this covenant shall cover the following geographic area during said period: The following Texas Counties: Dallas, Tarrant, Ellis, Denton, Rockwall, Kaufman, and Collin.

For two and a half years, as Mobile's franchisee, Hill contacted car dealerships and made car trim repairs in his two-county area. In April 1985, after Hill had not paid his franchise fees for several months, Mobile Auto Trim picked up his van and terminated the franchise agreement. That day, after the franchise agreement had been terminated, Hill contacted a prior customer, a car dealership manager in Dallas County. Thereafter, Mobile Auto Trim sought a temporary injunction to enjoin Hill from competing with it or contacting car dealership managers in the seven counties listed in the covenant not to compete.

Courts in Texas encounter two general varieties of covenants not to compete: covenants specifying that the seller of a business will not compete with the buyer, and covenants specifying that an employee, upon discharge, will not compete with the former employer. These covenants commonly set forth temporal and geographical restraints on the promisor's ability to compete with the promisee, which restraints must be reasonable.

Under the common law of contracts, a covenant not to compete is in restraint of trade and its terms are enforceable only if, and to the extent that, they are, in other respects, also reasonable. [FN1] Whether a covenant not to compete is reasonable is a question of law for the court. A covenant is unreasonable "if it is greater than is required for the protection of the person for whose benefit the restraint is imposed or imposes undue hardship upon the person restricted." *Weatherford Oil Tool Co. v. Campbell*, 340 S.W.2d at 951; *Henshaw v. Kroenecke*, 656 S.W.2d at 418; see also Restatement (Second) of Contracts § 188.

FN1. Some states prohibit all or most forms of restrictive covenants by statute.

A covenant must meet four criteria in order to be deemed reasonable. First, the

covenant must be necessary for the protection of the promisee. That is to say, the promisee must have a legitimate interest *171 in protecting business goodwill or trade secrets. Second, the covenant must not be oppressive to the promisor, as courts are hesitant to validate employee covenants when the employee has nothing but his labor to sell. In this respect, the limitations as to time, territory, and activity in the covenant not to compete must be reasonable. Third, the covenant must not be injurious to the public, since courts are reluctant to enforce covenants which prevent competition and deprive the community of needed goods.

Finally, as with any contract, the non-competitive agreement should be enforced only if the promisee gives consideration for something of value. This doctrine promotes economic efficiency. In the case of covenants not to compete incident to the sale of a business, the seller's promise not to compete with the buyer increases the value of the business to the buyer. Without such a covenant the value of the business would be reduced, lessening the likelihood that businesses would be purchased. In employee covenants, the special training or knowledge acquired by the employee through his employer is valuable consideration and often enhances the value of the employee to other firms. To allow employees to use or sell this valuable training or knowledge upon leaving a firm would create a disincentive for employers to train or educate employees.

But, the covenant before us today cannot be clearly categorized as either a covenant incident to the sale of a business or a post-employment covenant to prevent utilizing special training or knowledge. Hill obtained his skills as an auto trim repairman prior to his franchise agreement with Mobile Auto Trim. Hill bought a franchise from Mobile for approximately \$42,000 plus 5% of his gross revenues. In effect, Hill paid for the use of Mobile's name and accompanying goodwill.

This restrictive covenant is plagued by a lack of reasonableness. Initially, there is an apparent absence of consideration. What value did Mobile give in exchange for Hill's promise not to compete? It was not specialized training or knowledge, for that was acquired by Hill prior to his franchise agreement, nor was it Mobile's promise not to compete with Hill after their business relation terminated. And, although Mobile Auto Trim alleges that its trim services are trade secrets, they do not provide any substantiation, did not bring suit to stop the use of their trade secrets, and are willing to let Hill use their techniques anywhere except the Dallas-Fort Worth metroplex.

More importantly, we find no legitimate business interest of Mobile which the covenant is necessary to protect. The contract alleges, and the record indicates, that the purpose of this covenant not to compete was to prevent Hill from exploiting the contacts and "the substantial goodwill [that] exist[s] between the Company and the managers of the various car dealerships." However, there exists not only business goodwill but also franchisee goodwill. When people leave a business to work for another or to open a firm of their own, many are capable of taking with them a sizeable number of the clients whom they had served at their previous place of employment. If they were not in possession of some type of personal magnetism or personal goodwill, they would be incapable of retaining those clients or customers. Shrewd employers and franchisors know this and seek to deprive the employee/franchisee of the fruits of his goodwill by requiring that he enter into an agreement containing a restrictive covenant. The covenant *172 is generally unfair to the employee/franchisee, for when that person is placed in the position of being unable to compete with the former employer/franchisor, his personal goodwill is effectively neutralized.

In the past this court has modified restrictive covenants in order to make the time, area and scope of the covenant reasonable. But, there has never been a presumption that so long as the restriction does not encumber the former franchisee's ability to compete for a long time or over a wide radius, the covenant is otherwise deemed fair. To presume such would be to ignore the fact that the franchisor ordinarily has no right to prohibit fair competition. Tex.Const. art. I, § 26. If fair competition is injurious to the franchisor, then so be it: it is but a normal

effect of a free market economy.

Finally, the covenant is oppressive to the promisor, Hill. Not only has he lost his franchise and investment therein, he is now prevented from using his previously acquired skills and talent to support him and his family in the county of their residence. We recognize that a man's talents are his own. Absent clear and convincing proof to the contrary, there must be a presumption that he has not bargained away the future use of those talents. Professor Williston referred to this concept in his authoritative work on contract law, and it is a fitting summary of the nearly forgotten notion:

A man's aptitudes, his skill, his dexterity, his manual or mental ability-- all those things which in sound philosophical language are not objective, but subjective--they may and they ought not to be relinquished by a servant; they are not his master's property; they are his own property; they are himself. There is no public interest which compels the rendering of those things dormant or sterile or unavailing; on the contrary, the right to use and to expand his powers is advantageous to every citizen, and may be highly so for the country at large.

S. Williston, *A Treatise on the Law of Contracts* § 1646 (rev. ed. 1937) (citing *Morris v. Saxelby*, 1 A.C. 688, 714 [H.L.1916]).

Today, we are presented with an individual who is skilled in auto trim repair and are asked to prohibit him from engaging in a common calling. We refuse to do so. The longevity of the reasonableness approach has been its flexibility. "The changing conditions of life modify from time to time the reasons for determining whether the public interest requires that a restrictive stipulation shall be deemed void as against public policy." *Samuel Stores, Inc. v. Abrams*, 94 Conn. 248, 252, 108 A. 541, 543 (1919). In 1982, the Utah Supreme Court refused to enforce a hearing aid distributor's non-competition agreement against a former salesman, setting forth the standard which we adopt today: "[c]ovenants not to compete which are primarily designed to limit competition or restrain the right to engage in a common calling are not enforceable." *Robbins v. Finlay*, 645 P.2d 623, 627 (Utah 1982).

The issue before us is whether Mobile Auto Trim is entitled to have the restrictive covenant enforced pending trial on the merits. *Iranian Muslim Organization v. City of San Antonio*, 615 S.W.2d 202, 208 (Tex.1981). Mobile must show a probable right of recovery and a probable injury in order to justify the issuance of a temporary injunction. *Transport Co. of Texas v. Robertson Transports*, 152 Tex. 551, 261 S.W.2d 549 (1953). For the foregoing reasons, we hold there is no probable right of recovery. Therefore, we reverse the judgment of the court of appeals, dissolve the temporary injunction, and hold the restrictive covenant in the franchise agreement void in all respects.

GONZALEZ, Justice, dissenting.

II. *The Reasonableness Test.*

A covenant not to compete is a restraint of trade and its terms are enforceable only if they are reasonable. A covenant is unreasonable "if it is greater than is required for the protection of the person for whose benefit the restraint is imposed or imposes undue hardship upon the person restricted." See Restatement (*174 Second) of Contracts § 188 (1979). The limitations as to time, territory and activity in the covenant not to compete must be reasonable. *Frankiewicz v. National Comp Assocs.*, 633 S.W.2d 505, 507 (Tex.1982); *Justin Belt Co. v. Yost*, 502 S.W.2d 681, 685 (Tex.1973). To determine if a territorial limit in a covenant not to compete is reasonable, the court balances the interests of the promisor, the promisee and the public. *Matlock v. Data Processing Sec., Inc.*, 618 S.W.2d at 329. See Restatement (Second) of Contracts § 188 comment d (1979); 6A Corbin on Contracts § 1394 (1962).

Whether a covenant not to compete is reasonable is a question of law for the court. If the restraints in the covenant not to compete are unreasonable, the court will enforce the covenant but grant an injunction for a time, area and scope that is reasonable.

Here, the purpose of the covenant not to compete was to prevent Hill from exploiting the

contacts and goodwill he made while working in his assigned franchise area. The covenant attempted to prohibit Hill from calling on any car dealerships in the entire seven-county Dallas-Fort Worth metroplex because managers from Hill's assigned area often move to other dealerships in the surrounding counties. The record also reveals that Hill called on no car dealership managers outside his assigned franchise area and thus generated no goodwill except in that area.

Because protecting customer contacts and goodwill are proper reasons for having a covenant not to compete, I would affirm the temporary injunction; however, I would modify the temporary injunction to enjoin Hill from competing in his assigned two-county area and from contacting any car dealership managers in the seven-county area that he had prior contacts with during the franchise agreement time period. To enjoin Hill from competing or contacting any manager in the entire seven-county area would be a greater restraint than is reasonably necessary to protect Mobile Auto Trim.

I also disagree with the manner in which the court frames the issue. The central question is not whether Hill is being prohibited from engaging in a "common calling," but whether the covenant not to compete is reasonable. The court recites a four-part test to determine the reasonableness of a covenant not to compete: (1) the promisee must have a legitimate interest in protecting business goodwill or trade secrets; (2) the limitations as to time, territory and activity in the covenant must be reasonable; (3) the covenant must not be injurious to the public; and (4) the promisee must give consideration for the covenant. The court then concludes that the covenant not to compete is "plagued by a lack of reasonableness" under this test. I disagree.

1. *Protection of the Promisee's Legitimate Interests.*

The court concludes there is "no legitimate business interest of Mobile which the covenant is necessary to protect." 725 S.W.2d 172. The court then proceeds to create a new principle by distinguishing between "business goodwill" of the franchisor and "personal goodwill" of the franchisee. The court also suggests that the goodwill developed by the franchisee on behalf of the franchisor belongs to the franchisee, and that the franchisor cannot legitimately seek to protect that goodwill. This principle is inconsistent with Texas law.

The authorities that have considered this issue have uniformly determined that goodwill developed by either a franchisee or an employee accrues to the benefit of the franchisor or employer, respectively, and is an interest in which the franchisor or employer is entitled to protect. In *Henshaw v. Kroenecke*, 656 S.W.2d at 418, we stated:

Henshaw had a right to protect himself from the possibility that Kroenecke would establish a rapport with the clients of the business and upon termination take a segment of that clientele with him.... Henshaw had a legitimate interest to protect, and therefore, the covenant was reasonable.

See *Weatherford Oil Tool Co. v. Campbell*, 340 S.W.2d at 951; *Spinks v. Riebold*, 310 S.W.2d at 669. See also *Gill v. Guy Chipman Co.*, 681 S.W.2d 264, 268 (Tex.App.--*175 San Antonio 1984, no writ) (employee restraint necessary to protect diversion of employer's business); *Investors Diversified Servs., Inc. v. McElroy*, 645 S.W.2d 338, 339 (Tex.App.--Corpus Christi 1982, no writ) (injury is the diversion of customers and goodwill from the employer); *Leck v. Employers Casualty Co.*, 635 S.W.2d 450, 453-54 (Tex.App.--Fort Worth 1982, no writ) (protecting employer from harm to the business by employee diverting customers); *Dittmer v. Source EDP, Texas, Inc.*, 595 S.W.2d 877, 880 (Tex.Civ.App.--Dallas 1980, no writ) (contacts with employer's customers were protectable assets); *Kidde Sales & Serv., Inc. v. Peairson*, 493 S.W.2d 326, 329-30 (Tex.Civ.App.--Houston [1st Dist.] 1973, no writ) (covenant valid where employee acquires special influence over employer's customers giving employee advantage over employer in competition for customer's business); *Hospital Consultants, Inc., v. Potyka*, 531 S.W.2d 657, 661 (Tex.Civ.App.--San Antonio 1975, writ ref'd n.r.e.) (employer has sufficient

interest in retaining customers to support covenant not to compete)....

2. *Limitations as to Time and Territory.*

The court held that the limitations as to time, territory and activity in the covenant not to compete were unreasonable. I agree that the area of restraint in the covenant is greater than is reasonably necessary to protect Mobile Auto Trim. However, after reforming the area limitation to enjoin Hill from competing with Mobile in his assigned two-county area and from contacting any car dealership managers in the assigned seven-county area that he had prior contacts with as a franchisee, the limitations are reasonable. The problem is the court's refusal to follow well established precedent and reform the covenant to impose reasonable limitations.

The court correctly states that "[i]n the past this court has modified restrictive covenants in order to make the time, area and scope of the covenant reasonable." 725 S.W.2d 172 (emphasis added). However, the court then concludes, based on a skimpy record, that the covenant not to compete is void. The implication is that such covenants will not be modified by the court's equity powers in the future.

The long-standing practice of Texas courts is to reform covenants not to compete and enforce those covenants to the extent that the restraint imposed is reasonable. This approach is also adopted by the Restatement. Restatement (Second) of Contracts § 184 comment b (1979). See 6A Corbin on Contracts § 1390, at 70-71 (1962); 14 S. Williston, A Treatise on the Law of Contracts § 1647C, at 293 (3d ed. 1972). Texas courts should continue this practice.

Because Hill is not prohibited from providing for his family in his home county or elsewhere by working for a body shop or car dealer as long as he does not call on car dealers and make car trim repairs from a mobile van, the covenant not to compete is reasonable as reformed. ...

IV. *Distinction Between Covenants Not To Compete In Franchise Agreements and Employment Contracts.*

From the references to "employee/franchisee" and "employer/franchisor" it is apparent that the court makes no distinction between covenants not to compete contained in contracts for employment and contracts for the sale of franchises. I disagree. This case involved a *franchise relationship, not an employment relationship.* ...

Franchise relationships are far different from employment relationships. The reason for drawing a clear distinction is that courts scrutinize covenants not to compete in employment relationships more closely than covenants not to compete associated with the sale of a business. The reason for this difference in scrutiny is the assumption that an employer has a superior bargaining position as compared to the employee resulting in some type of economic coercion against the employee. Restatement (Second) of Contracts § 188 comment g (1979). In contrast, the franchisee pays the franchisor a fee and royalties to learn and use the franchisor's successful business format. The franchisee, unlike an employee, is not compelled to enter the relationship to have a livelihood.

Protectable interests in the franchisor have been recognized by every court that has considered the issue. Against these interests, we must balance the public's interest in free and full competition. The best way to foster new business and competition in Texas is to hold persons, absent any disability, to the terms of their contracts. In this way, parties can define their legal relationships in advance in the security that those relationships will be upheld.

285 F.3d 581
Seventh Circuit.

IDX SYSTEMS CORP v. EPIC SYSTEMS CORP
April 1, 2002.

EASTERBROOK, Circuit Judge.

Both IDX Systems and Epic Systems make software for use in managing the financial side of a medical practice: billing, insurance reimbursement and other collections, and the like. During the 1980s IDX sold this software package to two medical groups that later merged into the University of Wisconsin Medical Foundation, which now comprises more than 1,000 physicians. The Foundation continued to use *583 IDX software until December 2000, when it switched to software developed by Epic. IDX believes that Mitchell Quade and Michael Rosencrance, former employees of Epic who came to manage data processing at the Foundation, not only instigated this change but also used their new positions to transfer valuable information to Epic. According to IDX's complaint, over the course of a year Quade and Rosencrance personally, and with the aid of other Foundation employees, furnished Epic with details about how IDX's software works, enabling Epic to enhance its own package and ultimately take the Foundation's business--and to match up better against IDX in the competition for other customers.

IDX's complaint under the diversity jurisdiction of 28 U.S.C. § 1332 charges the Foundation, Quade, and Rosencrance with stealing IDX's trade secrets and breaking contractual promises of confidentiality; it charges Epic with tortiously inducing the other defendants to do these things. The district court dismissed the tort claims against Epic on the pleadings, observing that Wis. Stat. § 134.90(6)(a) overrides any theory that conflicts with the state's law of trade secrets. Later it pared all contract-based claims out of the case, ruling that the confidentiality agreements are invalid under Wisconsin law (which the parties agree governs) because they do not contain temporal and geographic limitations. Finally, the court granted summary judgment to the defendants on the trade-secret claim, after concluding that IDX had failed to identify with specificity the trade secrets that it accuses the defendants of misappropriating. 165 F.Supp.2d 812 (W.D.Wis.2001). We shall start where the district court ended: with the trade-secret claim.

Trade secrets are a subset of all commercially valuable information. Wisconsin has followed the Uniform Trade Secrets Act in defining "trade secret" this way:

"Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique or process to which all of the following apply:

1. The information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.
2. The information is the subject of efforts to maintain its secrecy that are reasonable under the circumstances.

Wis. Stat. § 134.90(1)(c). Thus to show that particular information is a trade secret, a firm such as IDX must demonstrate that it is valuable, not known to others who might profit by its use, and has been handled by means reasonably designed to maintain secrecy. Like the district judge, we think that IDX failed to do this. It has been both too vague and too inclusive, effectively asserting that all information in or about its software is a trade secret. That's not plausible--and, more to the point, such a broad assertion does not match up to the statutory definition. Reluctance to be specific is understandable; the more precise the claim, the more a party does to tip off a business rival to where the real secrets lie and where the rival's own development efforts should be focused. Still, tools such as protective orders are available to make this process less risky, and unless the plaintiff engages in a serious effort to pin down the secrets a court cannot do its job.

According to IDX, "a 43-page description of the methods and processes underlying and the inter-relationships among various features making up IDX's software package" is specific enough. No, it isn't....

Because it is hard to prove that particular information qualifies as a trade secret, many producers of intellectual property negotiate with their customers for additional protection.

This is a step that Wisconsin permits. ... IDX and the Foundation promised not to allow the software and related materials "furnished by" IDX to be "examined ... for the purpose of creating another system" and vowed in addition not to "use or disclose or divulge to others any data or information relating to" the system or "the technology, ideas, concepts, know-how, and techniques embodied therein." IDX has evidence (enough to survive summary judgment) that the Foundation, Quade, and Rosencrance broke these promises by describing IDX's system in detail to Epic and helping it duplicate those features that the Foundation liked. Nonetheless, the district judge held, the promises are unenforceable ***585** because they are unlimited in temporal and geographic scope, and thus unduly restrain trade.

In reaching this conclusion, the district court relied on decisions requiring restrictive covenants limiting competition between employers and their ex-employees to be reasonable, a limitation that in Wisconsin entails some restrictions on time and scope. Rules limiting the extent of no-compete clauses are based on the fact that they tie up human capital and, if widely adopted, may have the practical effect of preventing horizontal competition in economically significant markets. But neither rationale applies to contracts that restrict the use of particular information between businesses that have vertical (supplier-to-customer) rather than horizontal (competitor-to-competitor) relations. IDX did not contract for limitations on Epic's ability to compete; contracts between IDX and the Foundation are vertical in nature and protect intellectual property without affecting competition. They may compel rivals such as Epic to do more work to develop software independently, but this promotes rather than restricts competition. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 94 S.Ct. 1879, 40 L.Ed.2d 315 (1974), holds that trade-secret law is compatible with antitrust law; the same can be said for contracts protecting intellectual property that, though not demonstrably a trade secret, is commercially valuable. Rivals such as Epic, as non-parties to the vertical arrangements, remain entitled to discover and use the information independently and to compete vigorously. Nothing in the antitrust laws gives one producer a right to sponge off another's intellectual property, even when the producer of that knowledge has a market share much larger than IDX's. See *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C.Cir.2001) (en banc).

The parties have not cited, and we have not found, any Wisconsin statute or decision subjecting non-disclosure agreements between suppliers and users of intellectual property to the rules that govern non-competition clauses between employers and employees. To the contrary, *Fullerton Lumber Co. v. Torborg*, 270 Wis. 133, 139, 70 N.W.2d 585, 588 (1955), tells us that Wisconsin allows "a much greater scope of restraint in contracts between vendor and vendee than between employer and employee." Restrictions on disclosure may make intellectual property more valuable to its producer, and thus promote both the creation of knowledge and competitions against other firms in the same industry. No one doubts this with physical property: General Motors is entitled to control 100% of its own output of mufflers, without handing any of them over to Ford or Toyota or Volkswagen. Permitting a producer the full return on its investment in mufflers (or any other product) is essential to promote investment in productive assets and rivalry with other producers. Just so with knowledge, an increasingly vital input into production. ***586** Why should IDX or any other maker of intellectual property be placed under legal rules that effectively entitle its rivals to a chunk of that asset's value?

No Wisconsin decision of which we are aware requires temporal or geographic limits as a condition to the enforcement of a non-disclosure agreement for intellectual property. It is impossible to understand how a non-disclosure agreement *could* place "geographical" limits on the dissemination of intellectual property comparable to those restricting the locale where a salesman may try to drum up customers for a new employer. If the Foundation were forbidden to disclose the details to Epic in Wisconsin, but allowed to do so in Indiana, that would be the same thing as permitting disclosure everywhere (and thus nixing all contractual limits)--for Epic could sell worldwide any software derived from what it learned in Indiana. Knowledge does not respect borders. *ProCD*, a case that the district court did not mention, enforced as a matter of

Wisconsin law a contract placing worldwide restrictions on the use of intellectual property embedded in software.

Temporal limitations could make more sense. Perhaps Wisconsin's courts would deem contracts such as those between IDX and the Foundation to cover only information that is not generally known. What would be the point of forbidding the Foundation to talk in public about features of IDX's system that had been the subject of a review in a trade publication? But it is too early in this litigation to decide whether Wisconsin would curb the unqualified scope of this contractual language--and, if some limits would be interpolated into the text, whether these would shelter the actual disclosures that the Foundation made to Epic. (The Foundation contends, for example, that it had customized IDX's software extensively and disclosed to Epic details about its own additions rather than any information "furnished by" IDX and of which Epic was unaware before the disclosures. It also contends that IDX cannot establish damages. But these and other factual arguments must be developed through discovery rather than decided at the complaint stage.) ...