Montana Law Review

Volume 49
Issue 2 *Summer 1988*

Article 2

July 1988

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NOTE

THE POST-EMPLOYMENT COVENANT NOT TO COMPETE: AN OLD DOG DOING A NEW TRICK

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I. INTRODUCTION

In 1984 the public accounting firm of Dobbins, Deguire and Tucker, P.C. (hereinafter Dobbins), filed suit in Missoula County against three of its former employees alleging that each of the former employees had violated their employment contracts with Dobbins.[1] The contract required each employee to pay Dobbins a fee if the employee obtained a Dobbins' client within twelve months after their employment with Dobbins ceased.[2] The amount of the fee was to equal 100 percent of the gross fees billed by Dobbins to the obtained customer, over the twelve-month period preceding the employee's termination.[3] Additionally, the employees were to pay the fee in "monthly installments over a three year period" with interest accruing at 8 percent per annum.[4]

Upon motion by the defense, the trial court dismissed the suit for failure to state sufficient facts upon which relief could be granted.[5] The trial court ruled that the payment terms Dobbins sought to enforce were void as a matter of law under section 28-2-703 of the Montana Code Annotated.[6] Specifically, the liquidated damages clause was found to constitute a penalty for breach of the employment agreement and thus was in restraint of trade.[7]

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1. Dobbins, Deguire & Tucker, P.C. v. Rutherford, ___ Mont. ___, ___, 708 P.2d 577, 578 (1985).
2. *Id.* at ___, 708 P.2d at 578.
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.* at ___, 708 P.2d at 578-79. (MONT. CODE ANN. § 28-2-703 (1987) was previously enacted as Sec. 2246, Civ. C. 1895; re-enacted as Sec. 5057, Rev. C. 1907; re-enacted as Sec. 7559, R.C.M. 1921; re-enacted as Sec. 7559, R.C.M. 1935; re-enacted as R.C.M. 1947, 13-807.)
7. Appellant's Opening Brief at A-2, *Dobbins*, ___ Mont. ___, 708 P.2d 577 (1985), Memorandum and Order of the lower court (available at the Montana State Law Library in

On appeal by the plaintiff, a unanimous Montana Supreme Court reversed the holding of the lower court and remanded the case for further proceedings.[8] In doing so, the court announced that post-employment restraints that meet a test of reasonableness[9] are enforceable. Furthermore, the court limited its holding in an earlier case that appeared to have been controlling[10] and seemingly read new exceptions into the time tested section 28-2-703.[11]

The Montana Supreme Court's decision in *Dobbins* opened a Pandora's box of legal issues concerning the post-employment restraints placed on employees under employment contracts. This note will explore the effects the holding in *Dobbins* may have on employer-employee relationships in Montana and factors practitioners should consider when drafting or litigating a *Dobbins* type restraint. However, to provide an understanding of the possible ramifications of the *Dobbins* case, this note will initially review relevant decisions that preceded *Dobbins*.

II. HISTORY

In 1895[12] Montana codified the public policy that declared unenforceable those contracts which restrained trade.[13] In doing so, Montana joined with the minority of states having codified this policy.[14] The language adopted in 1895 remains intact today, codified as section 28-2-703 which provides that "[a]ny contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than is provided for . . . is

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Helena, Montana).

8. *Dobbins*, ___ Mont. at ___, 708 P.2d at 580.

9. *Id. See infra* notes 51-52 and accompanying text.

10. J. T. Miller Co. v. Madel, 176 Mont. 49, 575 P.2d 1321 (1978); *see infra* notes 53-54 and accompanying text.

11. *Dobbins*, ___ Mont. at ___, 708 P.2d at 759; for a listing of cases construing this statute see *infra* note 19.

12. Before this time, Montana had adopted the common-law rule that "contracts in restrain[t] of trade, generally, have been held to be void; while those limited as to time or place or persons have been regarded as valid, and duly enforced." Newell v. Meyendorff, 9 Mont. 254, 260, 23 P. 333, 334 (1890) (quoting Alger v. Thatcher, 19 Pick. 51 (1837)).

13. Currently codified as MONT. CODE ANN. § 28-2-703 (1987). *See supra* note 6 for prior codification. (The language was adopted from CAL. CIV. C. Sec. 1673; FIELD CIV. C. Sec. 833).

14. *See* Comment, *Covenant not to Compete: A Survey of Kansas and Missouri Law*, 53 UMKC L. REV. 237, n.100 (1985) (citing ALA. CODE § 8-1-1 (1975); CAL. BUS. & PROF. CODE § 16600-02 (West 1964); COLO. REV. STAT. § 8-2-113-(2), (3) (1973 & Supp. 1982); HAW. REV. STAT. § 480-4 (1976); LA. REV. STAT. ANN. § 23:921 (West 1964); MICH. COMP. LAWS §§ 445.761, 445.766 (1948); N.D. CENT. CODE § 9-08-06 (1975); OKLA. STAT. ANN. tit. 15, § 217-19 (West 1966); S.D. CODIFIED LAWS ANN. §§ 53-9-8 to -11 (1980); WIS. STAT. ANN. § 103.465 (West 1974).

to that extent void."

Two exceptions to the statutory general rule are found in its companion sections which allow for various restraints on trade associated with the sale of goodwill of a business[15] and upon dissolution of a partnership.[16] From 1895 until today,[17] Montana statutes have authorized only those two exceptions.[18]

Since the adoption of section 28-2-703, the Montana courts have seldom had occasion to void contractual attempts to restrain trade.[19] However, in the three instances prior to *Dobbins* when the court construed the validity of post-employment restraints on former employees, the court invalidated such attempts.[20]

In *Best Dairy Farms, Inc. v. Houchen*,[21] the Montana Supreme Court first considered the validity of an employer's attempt to restrain a former employee from engaging in competition. The plaintiff in *Houchen*, a milk products distributor, sought to enjoin its former salesperson from soliciting route customers whom the salesperson had served as its employee.[22] Although the employ-

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15. MONT. CODE ANN. § 28-2-704(1987) provides:

(1) One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business within the areas provided in subsection (2) so long as the buyer or any person deriving title to the goodwill from him carries on a like business therein.

(2) The agreement authorized in subsection (1) may apply in:

(a) the city where the principal office of the business is located;

(b) the county where the principal office of the business is located;

(c) a city in any county adjacent to the county in which the principal office of the business is located;

(d) any county adjacent to the county in which the principal office of the business is located; or

(e) any combination of the foregoing.

16. MONT. CODE ANN. § 28-2-705 (1987) states: "Partners may, upon dissolution of a partnership, agree that one or more of them may not carry on a similar business within the areas provided in 28-2-704(2)."

17. In 1983, the legislature enlarged the geographical area in which a qualifying party could protect their interest from competition to include adjacent counties. Act of 1983, 1983 Mont. Laws 432, § 2 (codified as amended at MONT. CODE ANN. § 28-2-704(2)(c), (d), (e) (1987).

18. J. T. Miller Co. v. Madel, 176 Mont. 49, 52-53, 575 P.2d 1321, 1323 (1978).

19. First Am. Ins. Agency v. Gould, 203 Mont. 217, 661 P.2d 451 (1983) (covenants prohibiting employee from utilizing experience obtained through employment constituted an unlawful restraint on trade); Lar-Con Corp. v. Murman Properties, Ltd., 188 Mont. 183, 612 P.2d 676 (1980) (covenant not to compete upon sale of goodwill of a business prescribed area greater than that allowed under MONT. CODE ANN. § 28-2-704 and thus was void); J.T. Miller Co. v. Madel, 176 Mont. 49, 575 P.2d 1321 (1978) (covenant prohibiting employee from competing with employer was not enforceable); Wylie v. Wylie Permanent Camping Co., 57 Mont. 115, 187 P. 279 (1920) (seller of corporate stock had no interest in goodwill of business and thus could not be restrained from competition).

20. *See infra* text accompanying notes 21-51.

21. 152 Mont. 194, 448 P.2d 158 (1968).

22. *Id.* at 195-97, 448 P.2d at 159-60.

ment contract between the parties was silent as to restrictions on post-employment solicitation of former route customers, the plaintiff-employer claimed that the defendant-employee breached his duty not to disclose confidential information he had obtained while in service of the employer.[23] The lower court rejected the employer's claim and rendered judgment for the defendant.[24]

In resolving the controversy, the court recognized that an employee may owe his former employer a duty not to disclose or use confidential information belonging to the employer.[25] However, this duty is an exception to the general rule.[26] It arises only when the information is confidential and is not readily accessible to the competition.[27] Thus, the court found that the duty did not apply to the facts before it. The central factor in the court's determination was that the "customer's names and addresses . . . [were] readily accessible to anyone," and thus the employee lacked knowledge of any information that would afford the employer such protection.[28]

In 1978, in *J.T. Miller Co. v. Madel*,[29] the court dealt with the question of whether an employment contract which prohibited an insurance salesman from soliciting customers of his former employer for five years was void as a restraint of trade under section 28-2-703.[30] The plaintiffs operated and managed a general insurance agency in Minnesota and employed the defendant, pursuant to an employment contract, as a field agent to sell credit life insurance to banking institutions. In 1975 the insurance agency transferred the agent to Montana. One year later, the agent resigned his

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23. *Id.*

24. *Id.*

25. *Id.* at 198-99, 448 P.2d at 160-61. The court explained that the employee's duty not to disclose confidential information descends from two sources. The first is the employer's property right to everything acquired by the employee through his employment. MONT. CODE ANN. § 39-2-102 (1987). The second is the common-law duty owed by an agent to principal: "[T]he agent has a duty . . . not to use or disclose . . . trade secrets, written lists of names, or other similar confidential matters . . . ." RESTATEMENT (SECOND) OF AGENCY § 396 (1957).

26. *Id.* at 199, 448 P.2d at 161. The court noted that "it is the general rule that in the absence of an express contract forbidding solicitation of a former employer's customers, an employee . . . may solicit the business of his former customers, and will not be enjoined from such solicitation at the insistence of his former employer." (*Citing with approval* Annotation, *Right in Absence of Express Contract to Enjoin Former Employee From Soliciting Complainants Customers*, 126 A.L.R. 758, 770 (1940)).

27. *Id.*

28. *Id.* Such information did not constitute a property right or trade secret because the information as to the identity of the customers was such "that anyone could easily ascertain who was delivering milk to a certain customer." *Id.* at 198, 448 P.2d at 160.

29. 176 Mont. 49, 575 P.2d 1321 (1978).

30. *Id.* at 50-52, 575 P.2d at 1322-23.

employment with the plaintiffs and "immediately commenced employment with a competing insurance company."[31] In response, the agency filed suit in district court seeking to enjoin the "defendant from contacting or soliciting any of plaintiffs' customers with whom defendant had at any time dealt with on behalf of plaintiffs."[32] All told, the injunction would have precluded the former agent from selling credit life insurance to twenty-four out of the 158 banks in Montana.[33] Following a bench trial, the district court held that the employment contract was void because it violated public policy.[34] On appeal before the Montana Supreme Court, the agency argued that the statute was not an absolute prohibition on restraints of trade, but allowed for reasonable restraints under the circumstances surrounding each particular contract.[35] Additionally, the agency contended that the contractual restraints at issue merely protected confidential information and thus were an exception under the holding in *Houchen*.[36]

In rejecting the employer's argument that the restraints were reasonable and thus enforceable, the court mandated that strict compliance with the statutory provisions was required for all covenants incident to employment contracts.[37] The court declared:

> This court requires strict compliance with the statutory provisions of . . . [Montana Code Annotated section 28-2-703] and companion sections . . . . [Montana Code Annotated sections 28-2-704 and 28-2-705]. Plaintiffs' restrictive covenant, in their employment agreement, clearly does not qualify under either statutory exception. . . . Accordingly, the directness of . . . [Montana Code Annotated section 28-2-703] in its structure and the broadness of its terms commands the conclusion that it applies to the facts of this case and prohibits the restraint asserted.[38]

Additionally, the court rejected the plaintiffs' argument that the restraints at issue were enforceable under the confidential information exception set forth in *Houchen*. The information used by the employee to locate and solicit the business of his former

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31. *Id.* at 51, 575 P.2d at 1322.
32. *Id.*
33. Appellant's Opening Brief at A-9, *Madel*, 176 Mont. 49, 575 P.2d 1321 (1978) (available at the Montana State Law Library in Helena, Montana). The parties stipulated to this number, which included only those banks the agent had previously contacted on behalf of the agency.
34. *Madel*, 176 Mont. at 51, 575 P.2d at 1322. *See also* Appellant's Opening Brief, Record at 5.
35. *Madel*, 176 Mont. at 52, 575 P.2d at 1323.
36. *Id.* at 53, 575 P.2d at 1323.
37. *Id.*
38. *Id.* at 52-53, 575 P.2d at 1323.

employer's clients was well within the public domain[39] and thus did not constitute confidential information that would demand judicial protection.[40] The court also explained the framework of the confidential information protection permitted under *Houchen*. The court stated that once section 28-2-703 was found to be applicable law, the plaintiff bears the burden "to show that the restrictive covenant did not violate this section."[41]

The court faced a similar situation to that in *Madel* in *First American Ins. Agency v. Gould*.[42] The plaintiff in *Gould*, a Great Falls insurance agency and former employer of the defendant, sought to enjoin the defendant from selling insurance in the Great Falls area.[43] The agency employed the defendant for approximately two and one half years as an insurance sales representative pursuant to an employment contract entered into at the inception of the defendant's employment. The contract contained both a covenant prohibiting competition within an area surrounding the plaintiff's agency, and a covenant not to disclose information obtained through the defendant's employment.[44] Upon leaving her employment, the defendant proceeded to open her own insurance agency, locating it in the vicinity of the plaintiff's agency.[45] Moreover, the defendant began soliciting business from customers to whom the defendant had sold policies while employed by the plaintiff.[46] Consequently, the agency brought suit to enforce the terms of the employment contract.[47] The trial court, however, denied the agency a permanent injunction and held that, as a matter of law, the covenants in the employment contract were void under section 28-2-703.[48]

On appeal, the agency argued for the enforcement of the covenants at issue. The court, in separate treatments, found both covenants to be unenforceable.[49] More importantly however, the court

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39. *Id.* at 54, 575 P.2d at 1323. ("[D]efendant did nothing more than to contact banks which were obviously known and open to all vendors . . . . The knowledge of the banks was clearly within the public domain.")

40. *Id.* at 55, 575 P.2d at 1324.

41. *Id.* at 53, 575 P.2d at 1323.

42. 203 Mont. 217, 661 P.2d 451 (1983).

43. *Id.* at 218-20, 661 P.2d at 452-53.

44. *Id.*

45. *Id.* at 220, 661 P.2d at 453.

46. *Id.* at 220-21, 661 P.2d at 453.

47. *Id.* at 220, 661 P.2d at 453.

48. *Id.* at 222, 661 P.2d at 453.

49. *Id.* at 223-24, 661 P.2d at 454. Initially, the court dismissed the issue of the covenants not to compete as blatantly prohibited under MONT. CODE ANN. § 27-2-703 (1987). Then, in a more thorough discussion, it held that the plaintiff failed to meet the burden of proving that the covenant not to disclose did not violate MONT. CODE ANN. § 27-2-703

analyzed the legal framework supporting the *Houchen* exception to section 28-2-703. This analysis centered on the proof a plaintiff would need to meet the initial burden to overcome the provisions of the statute. This burden, explained the court, could be met by substantial credible evidence that the employee took property from the employer[50] or violated the employer's confidence.[51]

III. The Court's Holding in *Dobbins*

In *Dobbins*, a unanimous Montana Supreme Court held that the contract provisions that the plaintiff sought to enforce did "not constitute a restraint of trade [as] prohibited by" section 28-2-703.[52] Furthermore, the court announced that the statute does not prohibit reasonable covenants in employment contracts. The test for reasonableness as set forth by the court requires: "(1) The covenant should be limited in operation either as to time or place; (2) the covenant should be based on some good consideration; and (3) the covenant should afford a reasonable protection for and not impose an unreasonable burden upon the employer, the employee, or the public."[53] The application of this test, said the court, "requires a balancing of the competing interests of the public as well as the employer and employee."[54]

Consequently, with its declaration of the reasonableness standard, the court was forced to reexamine its holding in *Madel*. The court recognized the conflict between the rule announced in *Dobbins* and that of *Madel*, stating: "[t]here are statements made in *Madel* which are sufficiently broad to support the conclusion of the district court that any type of a restriction upon the exercise of a lawful profession must be invalidated."[55]

Thus, the court construed its holding in *Madel* as being limited by the fact that "the covenant not to compete was, in effect, an absolute prohibition upon . . . engage[ment] in the business of selling insurance."[56] The court additionally labeled the contract measure in *Madel* as prohibiting the plaintiff from doing business while the contract in *Dobbins* did not.

(1987).

50. *Id.* This property usually consists of records, lists of customers or other documents belonging to the employer. *See Houchen*, 152 Mont. at 198, 448 P.2d at 161.

51. *Id.* (as where the employer can prove that the employee memorized privileged information and used or disclosed such information outside the scope of employment.)

52. *Dobbins*, ___ Mont. at ___, 708 P.2d at 580.

53. *Id.*

54. *Id.*

55. *Id.* at ___, 708 P.2d at 579.

56. *Id.*

IV. Analysis of the Court's Holding in *Dobbins*

The court treated the reimbursement provision in the contract between Dobbins and the former employees, as a restrictive covenant.[57] However, instead of applying the strict compliance rule found in *Madel* and applied by the district court, the court applied a traditional "rule of reason" that allowed enforcement of the contract.[58] Although this approach seemingly reversed long professed tenets of the court when construing section 28-2-703 and its predecessors,[59] the opposite is true.

In interpreting the statute, the court cited a 1979 restraint-of-trade case testing the enforceability of a restrictive covenant in a lease agreement.[60] The court found the following factors essential for a restrictive covenant to be reasonable and thus enforceable:

> (1) it must be partial or restricted in its operation in respect to either time or place; (2) it must be on some good consideration; and (3) it must be reasonable, that is, it should afford only a fair protection to the interests of the party in whose favor it is made, and must not be so large in its operation as to interfere with the interest of the public.[61]

Although the court in *O'Neill* and *Dobbins* borrowed the test for reasonableness from other jurisdictions, Montana had long ago adopted such a standard.

In 1912, in a case of first impression regarding the construction the court would place on the newly enacted section 28-2-703, Justice Holloway proclaimed that the statute "is not novel . . . but declaratory of the common law."[62] In *Newell v. Meyendorff*,[63] the case cited in *Schwanekamp* as proclaiming the common law in Montana, the court explained that the rule of reason "embod[ied] the modern doctrine, as held by the authorities" and required that:

> "contracts in restraint of trade, generally, have been held to be void; while those limited as to time or place or persons have been regarded as valid, and duly enforce[able] . . . where the contract is neither injurious to the public nor the obligor, . . . then the law makes an exception and declares the agreement valid . . . if the

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57. *Id.*
58. *Id.*
59. *Id.* at ____, 708 P.2d at 580.
60. O'Neill v. Ferraro, 182 Mont. 214, 596 P.2d 197 (1979).
61. *Id.* at 218-19, 596 P.2d at 199 (quoting Eldridge v. Johnston, 195 Or. 379, 403, 245 P.2d 239, 250 (1952)). *See infra* note 65.
62. Schwanekamp v. Modern Woodmen of Am., 44 Mont. 526, 533, 120 P. 806, 807 (1912).
63. 9 Mont. 254, 23 P. 333 (1890).

contract is founded on valuable consideration, and a reasonable ground of benefit to the other party, it is free from objection, and may be enforced."[64]

Although the court in *Dobbins* did not cite its earlier holdings in *Schwanekamp* and *Newell* as authority for rejecting the strict compliance rule of *Madel*, it expressed essentially the same doctrine in both *O'Neill* and *Dobbins*.[65] However, in *Dobbins*, the court may have made one noticeable modification to the traditional rule of reason.

In explaining and limiting its holding in *Madel*, the court asserted that the contract provision it considered in *Madel* was "in effect, an absolute prohibition upon Madel's right to engage in the business of selling insurance."[66] Furthermore, when distinguishing the contractual provision in *Dobbins* from that in the *Madel* case, the court referred to the provision in the contract in *Madel* as "prohibit[ing] the defendant from engaging in . . . [his] business."[67] When reconciling this characterization of the *Madel* restrictions with its application,[68] one attribute giving rise to a restraint is discernible. The contract in *Madel* absolutely prohibited the employee from engaging in his trade with respect to only a portion of customers within the market.[69]

If indeed the court drew the line of reasonableness and thus enforceability of post-employment covenants to automatically exclude any covenants similar to that construed in *Madel*, then in *Dobbins* the court effectively amended the common-law rule of reason.[70] Thus, under this theory, any contract that prohibits the

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64. *Newell*, 9 Mont. at 260, 23 P. at 334 (*citing* Lawrence v. Barber, 10 Barb. 641; Chappel v. Brockway, 21 Wend. 157; Oregon Steam Navigation Co. v. Winsor, 20 Wall. 64 (1873)).

65. The tests adopted by the court in *Dobbins* were originally derived from Cook v. Johnson, 47 Conn. 175, 36 Am. Rep. 64 (1879) (considering the validity of a contractual restraint ancillary to sale of a business). *See Dobbins*, ___ Mont. at ___, 708 P.2d at 580, (quoting Eldridge v. Johnston, 195 Or. 379, 403, 245 P.2d 239, 250 (1952)).

66. *Dobbins*, ___ Mont. at ___, 708 P.2d at 579. The contract provision read:

> The Employee agrees and covenants that for a period of five (5) years after the termination of this Agreement, he will not directly or indirectly own, manage, operate, control, be employed by, or participate in or be connected in any manner with the ownership, management, operation or control of any business which sells . . . to any customer of Employer with whom the Employee has at any time had any dealings on behalf of the Employer; contact or solicit any customers of the Employer with whom the Employee has at any time had any dealings on behalf of the Employer; or sell or deliver to any customer of the Employer any insurance sold by Employee while an Employee of the Employer as set out in this contract.

67. *Id.*

68. *See supra* text accompanying notes 29 and 41.

69. *See supra* text accompanying notes 29 & 41.

70. At common law, restraints could absolutely prohibit practice of a trade as to any

former employee from serving even one prospective customer would be void as a per se restraint of trade.[71]

However, a more logical explanation of the court's classification of the *Madel* contract as an absolute restraint on trade is that the court merely restated what it considered to be its holding in *Madel*.[72] The court's summary of *Madel* supports this conclusion. The court treated the *Madel* covenant as one that totally precluded the employee from soliciting business "in any manner" in the entire Montana credit insurance market for a period of five years.[73] This interpretation reconciles with the balance of the decision where the court distinguished the *Dobbins* contract as one that did not contain per se absolute prohibition terms such as that in the *Madel* contract.[74] Furthermore, it is unreasonable to conclude that the court would take great pains to lay down the three tests constituting the rule of reason, without intending that the tests be applied to all contracts, even those similar in terms to that construed in *Madel*.[75] Consequently, while support exists for the contention that all constraints which absolutely restrain any trade are void,[76] the more logical approach would treat the court's reference to *Madel* as contemplating covenants acting to restrain trade as to an entire market.[77]

V. Considerations for Drafting and Litigating Restrictive Covenants in Employment Contracts

A review of the case law reveals four distinct exceptions to the section 28-2-703 statutory prohibition against restraints on trade. These exceptions include those found in sections 28-2-704[78] and

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segment of the market so long as the restrictions were reasonable. *See supra* note 69 and accompanying text.

71. This would include customers of the former employer as well as prospective customers within a geographic area.

72. *Dobbins*, ___ Mont. at ___, 708 P.2d at 579.

73. *Id.*

74. *Id.* The court's comparison of the *Dobbins* restraint to that in *Madel* was not done on a point by point basis. Rather, the court recited its holding in *Madel* without applying the rule of reason to the *Madel* covenant. Thus, when the court examined the *Dobbins* restraint pursuant to the rule of reason and proclaimed that the two provisions did not compare, the court was treating the *Madel* covenant as a complete bar on access to the market on which restraints were placed.

75. Application of the rule of reason to the facts in *Madel* may very well have led to the same conclusion that the five year restriction as to 24 out of 158 potential customers was unreasonable under the factors outlined in *Dobbins*.

76. *Dobbins*, ___ Mont. at ___, 708 P.2d at 579.

77. *Id.* at ___, 708 P.2d at 580.

78. *See supra* note 15 for text of statute.

-705[79] of the Montana Code Annotated; protection of an employer's confidential information authorized by section 39-2-102 of the Montana Code Annotated; and finally, those restraints allowed by the reasonableness test expressed in *Dobbins*. However, special caveats accompany reliance on each of these exceptions when drafting or litigating post-employment restrictive covenants.

A. *Statutory Exceptions*

When attempting to rely on either section 28-2-704 or section -705 of the Montana Code Annotated, practitioners should be cognizant of the degree of restraint seemingly allowed under these two exceptions. While these statutory exceptions primarily involve contractual restraints following the dissolution of a partnership or sale of goodwill of a business, situations conceivably may arise where such a transaction may additionally include provisions for an employment relationship. Examples of such instances include: when a partner is employed by the partnership, where a former partner is employed by a partnership immediately following dissolution, or where a former owner remains as an employee of the business subsequent to its sale. When such a situation occurs, the central issue is whether the contract is ancillary[80] to the dissolution of a partnership[81] or sale of goodwill of a business.[82] If the agreement is found to be ancillary to a qualifying event, analysis would then proceed to determine whether the terms sought to be enforced are within the statutory limits.[83]

One apparent distinction between an express exception and the *Dobbins* rule of reason is that the express exception allows for

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79. *See supra* note 16 for text of statute.

80. Ancillary contracts must be incidental to a larger transaction that transfers a protectable interest. *See* 17 C.J.S. *Contracts* § 241(2) (1963).

81. MONT. CODE ANN. § 28-2-704 (1987). *See supra* note 15 for text of statute.

82. MONT. CODE ANN. § 28-2-704 (1987). *See supra* note 15 for text of statute. Goodwill only attaches with actual ownership of the business. Where a stockholder only held stock in a business, the corporation owned the business' goodwill; thus, a covenant not to compete was ineffective as to the stockholder. Wylie v. Wylie Permanent Camping Co., 57 Mont. 115, 121, 187 P. 279, 218-82 (1920). *But cf.* Western Media, Inc. v. Merrick, ___ Mont. ___, ___, 727 P.2d 547, 549 (1986) (Non-competitive covenant upheld because officer-stockholder held goodwill upon dissolution). Attempts to guise employment contracts as a sale of goodwill have been resoundingly rejected by the courts. *See*, Comment, *Montana's Law Regarding Contracts in Restraint of Trade*, 30 MONT. L. REV. 185, 197 (1968) (authored by Cain).

83. The court strictly construes the geographic limitations set forth in MONT. CODE ANN. § 28-2-704 (1987). *See* Lar-Con Corp. v. Murman Properties, Ltd., 188 Mont. 183, 186, 612 P.2d 676, 678, (1980). Time limitations or other restrictions must be reasonable to qualify under the statutory exceptions. *See Jenson v. Olsen*, 144 Mont. 224, 227, 395 P.2d 465, 467 (1964).

protection within a geographical area, while under *Dobbins* the restrictive covenant may be limited to protecting particular customers.[84] Thus, the employer may enjoy broader protection from a statutory exception in a localized market. Additionally, if the rule of reason dictates that any prohibition of a trade constitutes an unenforceable restraint,[85] then absent privileged information,[86] the statutory exceptions provide the exclusive access to injunctive relief.[87]

Practitioners should also consider reasonableness when evaluating the enforceability of a provision initially authorized by the statutory exception. The test for reasonableness of a covenant is mainly raised when considering the duration of the covenant.[88] However, reasonableness of the degree of protection could conceivably become an issue if the employer attempted to apply both a statutory exception as to geographical area coupled with a *Dobbins* type provision as to particular clients.[89]

B. *Confidential Information*

An employer is afforded protection from disclosure or use by an employee of information in which the employer has a property interest.[90] This protection is derived from section 39-2-102 of the Montana Code Annotated, which reads: "[e]verything which an employee acquires by virtue of his employment, except the compensation, if any, which is due to him from his employer, belongs to the latter, whether acquired lawfully or unlawfully or during or after expiration of the term of his employment."[91] Thus, the primary criterion for invoking the confidential information excep-

84. *See supra* notes 57-77 and accompanying text.

85. *See infra* notes 98-117 and accompanying text.

86. *See supra* note 25 and accompanying text.

87. Injunctive relief is available under this statute, Treasure Chem.,Inc. v. Team Laboratory Chem. Corp., 187 Mont. 200, 202, 609 P.2d 285, 287 (1980). Damages may be sued for under Leiman-Scott,Inc. v. Holmes, 142 Mont. 58, 61, 381 P.2d 489, 490 (1963).

88. *See* Jenson v. Olson, 144 Mont. 224, 395 P.2d 465, *See generally* Annotation, *Enforceability of Restrictive Covenant Ancillary to Employment Contract, as Affected by Duration of Restriction*, 41 A.L.R.2d 15 (1955).

89. *See, e.g.*, Jenson v. Olson, 144 Mont. 224, 395 P.2d 465 (1964). Conceivably the court would look at the cumulative effect to determine whether the additional protection would be reasonable. The primary concern would be whether the employer would be limited to the so called reasonable boundaries of the statutory exceptions or rather would be able to add the *Dobbins* protection in cases where such protection may be warranted.

90. *Houchen*, 152 Mont. at 198, 448 P.2d at 161. For a discussion of the types of information giving rise to a property interest *see* Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 667-72 (1960).

91. *Houchen*, 152 Mont. at 198, 448 P.2d at 161.

tion[92] is whether the employer has a property right in the information that the employee uses or discloses. Before recognizing an employer's property right in any particular information a court must first determine that the information was gained by the employee through a trust or confidence and that the information is of a confidential nature.

When filing a complaint under section 39-2-102 of the Montana Code Annotated, practitioners should include allegations that (1) the employer took reasonable steps to secret the information at issue[93] and (2) that such information was confidential and not readily accessible to the competition.[94] Employers must plead and prove both allegations to avail themselves of the protection of this statute.[95] In the absence of such proof, a former employee will be free to use any information or knowledge gained during employment.[96] The remedies available for an employee's breach of a recognized employer confidence include both damages and permanent injunction.[97]

C. *Rule of Reason as Established in Dobbins*

When considering the application of the rule of reason as announced by the court in *Dobbins*, practitioners should review the

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92. Although the protection allowed an employer under MONT. CODE ANN. § 39-2-102 (1987) may be considered an exception to MONT. CODE ANN. § 28-2-703 (1987), this is somewhat of a misnomer. Only in those instances where there is an employment contract containing a covenant not to disclose does this exception apply. *Compare Gould*, 203 Mont. 217, 455 P.2d 451, *with Houchen*, 152 Mont. 194, 448 P.2d 158.

93. *See* Blake, *supra* note 90, at 673-74.

94. *Houchen*, 152 Mont. at 198, 448 P.2d at 161.

95. It is plaintiff's burden to prove that the information sought to be protected is of a confidential nature and, in cases where there is a written contract containing a covenant not to disclose, the plaintiff has the burden to prove that the covenant does not violate MONT. CODE ANN. § 28-2-703. However, the proof that the information is of a confidential nature and has been secreted works to overcome both burdens. *Gould*, 203 Mont. at 222-23, 661 P.2d at 454.

96. *Madel*, 176 Mont. at 55, 575 P.2d at 1324.

97. *Houchen*, 152 Mont. at 196, 448 P.2d at 160. While MONT. CODE ANN. § 39-2-102 (1987) provides protection as to confidential information obtained pertaining to the needs and or preferences of particular clients, no such safeguard is available to protect the goodwill associated with the customer relationship with the employee regardless of the resources the employer may have invested to nurture such goodwill. *See* Mathews Paint Co. v. Seaside Paint and Lacquer Co., 148 Cal. App.2d 168, 306 P.2d 113, 117 (1957) (cited with approval in *Madel*) (Plaintiff spent many years developing a clientele but failed to allege that the knowledge of former workers was confidential and the information was not readily accessible to the competition. However, the goodwill associated with the employees was not at issue in the case because the employer could not claim a property right in such goodwill). *See* Blake *supra* note 90, at 670-71. (The covenant not to compete is available to protect the employer's investment in building a goodwill relationship between the employee and customer).

policies and historical background which color such an application. The doctrine opposing restraint of trade dates back to eighteenth century England.[98] Courts of that era were faced with the task of harmonizing the policy considerations supporting freedom to contract versus the interest of society in reaping the economic utility from members of that society functioning in positions where they optimize their income and thus that of society.[99] While the circumstances of life have vastly changed since the creation of the rule of reason, courts continue to use the same formula to balance these interests.[100] One primary concern today centers on the restraints an employer may place on an employee to protect the employer's interest in the goodwill in the relationship the employee has established with customers.[101]

When applying the rule of reason, practitioners should remember that there is no set formula for finding any particular covenant to be reasonable.[102] Each case must and will vary due to the differences in factual situations.[103] Therefore practitioners should be especially diligent in obtaining factual information.

After initially determining that the covenant is limited as to time or place,[104] and is supported by valuable consideration,[105] the practitioner should examine relevant factors to determine if the covenant is reasonable. The initial inquiry when determining the reasonableness of a covenant is whether the employer's interests receive only that degree of protection which is necessary to preserve it.[106] Recognized employer interests that reasonably warrant protection include: trade secrets, confidential information and goodwill associated with customer relations.[107] After identifying an employer's protectable interest, the practitioner should evaluate it by identifying the variables bearing on the value of the interest.[108] Finally, the practitioner should consider this value in light of the

98. *See Newell*, 9 Mont. at 259-60, 23 P. at 333; *see also* Blake, *supra* note 90, at 629.

99. *Newell*, 9 Mont. at 260-61, 23 P. at 333-34. For an in-depth explanation of the development of this body of law, *see* Blake, *supra* note 90, at 627-46.

100. *See supra* notes 58-61 and accompanying text.

101. *See* Blake, *supra* note 90, at 647.

102. 17 C.J.S. *Contracts* § 246 (1963).

103. *Id.*

104. *Dobbins*, ___ Mont. at ___, 708 P.2d at 580. *See also* 17 C.J.S. *Contracts* § 247 (1963).

105. *Dobbins*, ___ Mont. at ___, 708 P.2d at 580.

106. *See* Blake, *supra* note 90, at 648-49.

107. *See generally* Blake, *supra* note 90, at 653-74.

108. *See* Blake, *supra* note 90. These factors include, but are not limited to, the nature of the contact with customers, the type of product sold, the time period required for the employee to establish this relationship, nature of the business, and the investment the employer has made in this particular interest.

degree of protection that the employer seeks to enforce.[109] Examples of protection factors include: geographical area of the restriction, restrictions as to service of particular customers, and duration of the restraint.[110]The practitioner then must consider whether the burden placed on the employee is reasonable.[111] Such a valuation is accomplished by considering various factors pertinent to the employee's burden. These factors include the broadness of the restrictions; the length of time for which the employee has worked for the employer; the length of time the employee would be barred from competing with the employer; the narrowness of the prohibition; and compensation, experience or training received during the term of employment.[112] Additional factors pertinent to this determination are the circumstances leading to the termination of employment.[113]

Policy considerations play a major role when attempting to determine whether a particular restraint constitutes an unreasonable burden on society.[114] The practitioner should be keenly aware of society's distaste for both monopolies[115] and unemployment.[116] Applying these factors, the practitioner should consider the size and impact on a market, the aggregate cost to society, and other public policies that are particular to a specific employment position or activity.[117]

VI. CONCLUSION

The *Dobbins* decision represents a major milestone in the area of post-employment restraints of trade. While the court seemingly revitalized the common-law rule of reason, questions still remain as to what constitutes a reasonable restraint. While some authority

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109. *See* Blake, *supra* note 90, at 651. *See also* 17 C.J.S. *Contracts*, § 246 (1963).

110. *See generally* Blake, *supra* note 90.

111. *Dobbins*, ___ Mont. at ___, 708 P.2d at 580.

112. *See* Blake, *supra* note 90, at 684-86. *See also* 17 C.J.S. *Contracts*, § 254 (1963).

113. Although the new wrongful discharge statute has not been tested in this area of the law, it is questionable whether an employer could enforce such a covenant after violating this act, codified as MONT. CODE ANN. § 39-2-901 through -914.

114. *See* Blake, *supra* note 90, at 686. *See also* 17 C.J.S. *Contracts*, § 249 (1963).

115. *See* 17 C.J.S. *Contracts*, § 250 (1963).

116. *Newell*, 9 Mont. at 260, 23 P. at 334. *But see* Blake, *supra* note 90, at 686-87.

117. *See* Blake, *supra* note 90, at 687. Many professional codes of conduct embody such a "profession specific" public policy. For example, the professional code of conduct governing the legal profession provides that: "A lawyer shall not participate in offering or making . . . a[n] . . . employment agreement that restricts the rights of a lawyer to practice after termination of the [employment] relationship, except an agreement concerning benefits upon retirement . . . ." Model Rules of Professional Conduct Rule 5.6(a) (1988). Where these codes prohibit restrictions on competition, attempted violations have been held unenforceable. *See, e.g.*, Hagen v. O'Connell, Goyak & Ball, P.C., 68 Or. 700, 683 P.2d 563 (1984).

supports the hairsplitting distinction that is drawn between reimbursing covenants and those that selectively prohibit competition,[118] such artificial distinctions are not necessary. Language in *Dobbins* supports the contention that all absolute restraints on any trade are void, but the better rule contradicts such an assumption. The rule of reason as enunciated by the court in *Dobbins* is centuries old and yet flexible enough to address the demands of twentieth century employment relationships. By weighing the interests of all concerned parties to determine whether terms are reasonable, society receives an economic windfall that remains unrealized.

By analyzing *Dobbins* in conjunction with previous Montana decisions, the parameters of the exceptions to section 28-2-703 of the Montana Code Annotated can be drawn. While many issues remain to be resolved, the practitioner should be aware of the opportunities afforded by the *Dobbins* exception.

118. *See* Annotation, *Covenants to Reimburse Former Employer For Lost Business*, 52 A.L.R. 139, 143 (1987).