

## NOTES

CONTRACTS—DIVISIBILITY OF CONTRACTS IN RESTRAINT OF TRADE.—The judicial problems and approaches to the question of the validity and enforcement of covenants not to compete, and in general of contracts in restraint of trade and of competition present an interesting and enlightening illustration of legal history and judicial development. They indicate the conflicts that have ever to be resolved, the diverse and contradictory considerations which must ever be balanced. This particular phase of judicial development has been slow and long. It has had to deal with the very bases of contracts and with public policy, that all-inclusive phrase, so often the legal 'last straw' for which jurists frantically clutch when the more substantial buoys of legal decision prove inefficacious.

Perhaps the clearest analysis of the question will come from an historical approach. The problem is fundamentally one of contracts. Basically, the question is addressed to the validity of the restraining contract. Naturally, as in all contracts, consideration, subject matter, intent, capacity of parties, are factors determining validity. But every contract owes its validity, in the final analysis, to the law, which is to enforce it. And one of the weights which the law utilizes in arriving at its decision regarding validity is 'public policy.'

Now the law in earlier days did condemn as invalid contracts in restraint of trade, as opposed to the public policy. This it did though strongly declaring that competent parties are to be given full freedom of contracting and that contracts so made are to be enforced by the courts.<sup>1</sup> The public policy here invoked is that which says that no person should be at liberty to deprive himself or the State of his labor, skill, talents, or ability by any contract.<sup>2</sup> It did not take long or deep thought to reveal to the courts that such a view is unfair not only to the party against whom it was erected but also to the one to whom the contract would be a benefit. Equally persuasive is a policy which recognizes the necessity of allowing one to bargain away his right to

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1. See: *U. of Newark Law Rev.* IV-#3, Pg. 344 Sp' 39.

2. *Mandeville v. Harmon*, 42 N. J. Eq. 185, 7 Ad. 37 (Ch. 1886). *Smith's Appeal*, 113 Pa. St. 579, 6 Atl. 251 (1886).

compete as part of the consideration for his sale of that which, acquired by his skill or talents or ability, he wishes to exchange or sell.<sup>3</sup>

It was not long, therefore, before the law had retreated from its declaration that contracts in restraint of trade or competition were invalid. But it was a retreat not a rout. And it was slow; and stubbornly yielded was the ground. The pendulum did not travel the entire arc. The presumption of invalidity still attached to such contracts. If the restraint were general, the contract was invalid; if it were partial, the contract might be good---might be, not 'was'. There then emerged the principle established today that a partial restraint may be recognized; that its validity depends upon its reasonableness, that its reasonableness is determined by looking to see whether it is only so extensive as is reasonably required to protect the interests of the party in whose favor it is given and not so large as to interfere with the interests of the public.<sup>4</sup>

Naturally the courts, as somewhat unwilling yielders, cling to whatever in the rejected theory may be logically adapted to the new. So the courts will carefully scrutinize such contracts, put the burden of supporting its reasonableness on the party seeking to enforce it, and in general will apply rules for construction of contracts most strongly against the writer.

However reluctantly or slowly, yet the law did withdraw its original arbitrary rule. Such a retreat did not result in a simple or settled situation. Having admitted the possibility of reasonable restraints of trade and competition, the courts thereby wished on themselves innumerable problems touching on reasonableness. What are the standards? How test for reasonableness? How extensive may a restriction be, geographically or temporally, and still be reasonable? The law has evolved uniform principles for many of these problems. We are concerned for the while with one phase of this problem not

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3. *Smith's Appeal*, *supra*.

4. *Trenton Potteries v. Oliphant*, 58 N. J. Eq. 507, 43 Atl. 723 (1899). *Mitchell v. Reynolds*, 1 P. Wms. 181 (1711). *Mandeville v. Harmon*, *supra*, note 2. *Nachamkis v. Goldsmith*, 101 N. J. L. 356, 128 Atl. 238, (E. & A 1925). *Althers v. Vreeland*, 36 Atl. 479 (Ch. 1897). *Sternberg v. O'Brien*, 48 N. J. E. 370, 22 Atl. 348 (Ch. 1891). *Taylor v. Nichols*, 73 N. J. Eq. 684, 69 Atl. 186 (1908).

finally or uniformly settled—at least in basis. Our consideration is to be of the severability of such contracts, the enforceability of part only of a restraining covenant. Can, or should, a court separate reasonable from unreasonable restrictions in one such contract and enforce the former? Is a restrictive clause, too broad geographically, to be enforced in so far as it is reasonable and this with or without regard to a designation in the contract of lesser area? If a contract limits competition for too long a time, can or should a court enforce it for a lesser time or declare the whole invalid?

Again, the most beneficial approach is through basic contract law. If a contract is one, then it stands or falls as one. But if it is divisible or severable, it can be enforced as to that part which is valid. Then comes the inquiry as to what is the test of divisibility and severability. What determines any contract to be entire or severable? The terms of any contract are primarily determined by the intent of the parties making the contract. Of course, by this is meant not subjective intent but intent as indicated by and gathered from the language, terms, subject-matter of the contract as well as by other facts and circumstances shown by the evidence.<sup>5</sup> Such is the rule for construction of contracts. Such, too, is the rule for determining whether a contract is entire or severable. The essential question is whether there was one assent to the whole transaction or a separate assent to separate and several things.<sup>6</sup> It is often asserted that the consideration determines the nature of the contract.<sup>7</sup> If there is one consideration for the contract it is entire, though the consideration be for the doing of several acts. This may well be the decisive factor if nothing else appears to indicate a contrary intent.<sup>8</sup> Apportionment of consideration is always to be considered in deciding in favor of divisibility. Indeed, in the absence of other factors it may be conclusive.

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5. *Orenstein v. Kahn*, 12 Del. Ch. 376, 119 Atl. 444 (1922). *Producers Coke v. Hillman*, 243 Pa. 313, 90 Atl. 144 (1914).

6. *Hartford Ins. Co. v. Campbell*, 95 Conn. 397, 111 Atl. 864 (1920). *Timber Co. v. Wardmill*, 135 Ia. 308, 112 N. W. 771. *Williston on Contracts*, Sec. 863.

7. *Beach v. Mullin*, 34 N. J. L. 343 (S. C. 1870).

8. *Orenstein v. Kahn*, *supra*, note 5. *Producers Coke v. Hillman*, *supra*, note 5. *Story on Contracts*, Sec. 24.

But if other facts and circumstances do appear, it becomes but one element, albeit an important and essential one, and entitled to great weight.<sup>9</sup> So it is then, that the fundamental inquiry is whether, in the light of the nature of the subject-matter and the consideration, the purpose of the contract, the language and terms thereof, there was an intent to give a single assent to a whole transaction consisting of several parts or several assents to several things. As Professor Williston puts it, the inquiry is, "Whether several were contracted for in one bargain or whether several bargains were made".<sup>10</sup>

General principles are usually more readily deducible than they are applicable to given problems. If we seek to apply to restraining contracts the principles just set forth, it is difficult to see how, over so long a course of time, and with such universality of decision, courts could ever have enforced portions of such contracts. If a covenant forbids competition 'within 500 miles of Jersey City,' it is difficult to see how any court could spell divisibility of area.<sup>11</sup> If a contract stipulates in return for employment that the employee not compete after termination of the relation, in Pennsylvania or outside Pennsylvania, it would seem no court could enforce as to the former and not as to the latter.<sup>12</sup> Even more clear should seem a case in which for one consideration a party agrees not to compete within four miles, and the court enforces as to two miles.<sup>13</sup> Of course, a contract with two separate and distinct covenants should cause little hesitancy.<sup>14</sup>

Courts, however, have gone far beyond the enforcement of contracts clearly severable on their faces. Indeed, it is not too much to say that there has been indulgence in judicial re-writing of contracts

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9. *Morris v. Wilboux*, 159 Ill. 648, 43 N. E. 837. *Orenstein v. Kahn*, *supra*, note 5.

10. Williston on Contracts, Sec. 863.

11. *Fleckenstein Bros. Co. v. Fleckenstein*, 76 N. J. L. 613, 71 Atl. 265 (E. & A. 1908).

12. *Monongahela Coal Co. v. Jutte*, 210 Pa. 288, 59 Atl. 1088 (1904).

13. *Bronnen v. Bouley*, 272 Mass. 67 (1930).

14. *Orenstein v. Kahn*, *supra*, note 5. *Coal Co. v. Jutte*, *supra*, note 12. *Union Locomotive v. Erie R. R.*, 35 N. J. L. 240 (S. C. 1871). *Stewart v. Lehigh Valley R. R.*, 38 N. J.L.503 (E. & A 1875)

and the forcing of compromise by equity. By what other name can be designated a procedure wherein equity interprets, "Within 500 miles of Jersey City" to mean "within Jersey City or within 500 miles of Jersey City" and announces the restriction so created to be divisible since it embraces "not one whole area but two disjunctively joined"?<sup>15</sup> Even were we to concede the validity of such a construction it would seem an insurmountable barrier to enforcement that the 'intent' of the parties was for and their 'assent' directed to, one restriction embracing the disjunctives. Without more, it is an unusually receptive magnet which can draw therefrom the requisite divisibility. Nor is this the extent of judicial conduct. There are decisions which go so far as to enforce a restriction more limited than that contracted for, even if the contract specifies no such smaller limit or sets no standard whatsoever for arriving at a reasonable restraint. The effect of such decisions, it would seem, is to withdraw the problem from contract law and place it in the scope of equity's discretionary powers. However desirable is such a result, its accomplishment does violence to the principles and bases of contract law.

This change in the law has not, however, been arbitrary or capricious. Judicial decisions resulting therein have been predicated on reason. It will be most instructive to consider what has been that reasoning. Reliance is had on an old judicial axiom more attractive for its brevity than for its veracity. We will assume, say the Courts, that parties intend a contract to be legal. As such, they must intend any restraint to be partial and reasonable and to be enforceable in so far as reasonable.<sup>16</sup> If accepted, this would settle the entire issue. But however true it may have been in the days of faith, certainly it is today obvious almost beyond the necessity for statement that parties do not always intend their contracts to be valid, binding, enforceable and limited to matter conformable with such intent. Parties to a restraining contract usually intend to enforce the restraint to the letter. If the limitation be four miles, they mean *four* miles and not

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15. Fleckenstein v. Fleckenstein, *supra*, note 11.

16. Trenton Potteries v. Oliphant, *supra*, note 4.

"four miles or so far as the court may decide is reasonable."<sup>17</sup> Of course, the party seeking enforcement will declare that the intent was not of total enforcement or none, of full protection or none. But an intent that the contract be enforceable in so far as reasonable, like any intent, must be the objective intent cognizable from a consideration of the contract as a whole. Subjective intent can no more be substituted here than in any phase of contract law. Again, if the prayer is for whole relief in terms of the contract, how can any court declare its adherence to and enforcement of contract law in the same breath which dictates enforcement in so far as it considers the restriction reasonable.<sup>18</sup> Judicial lips utter such sentiments as that the excess must be of trivial importance and merely technical, that the parts must be clearly severable, that the severed portion must be not of the substance or main purport of the clause. Such utterances are futile in view of the severances actually accomplished. Substantial application and actual decision are far more indicative of judicial trend than any formal worship at the throne or any lip-service to theory not applied.

It was stated earlier that the problem here under discussion was grounded in contract law and 'public policy'. The former, we have seen, affords no support to current judicial practice. We hesitate to center a discussion on the latter. It is, as was said, the proverbial 'last straw'. But in this instance it seems more substantial than the other. Generally, public policy is largely concerned with the effect of such contracts. They offer a most legitimate field for its operation. It is concerned with forestalling, on the one hand, a promisor's gathering of the wheat in a rich harvest while casting to another the chaff which is part thereof. It makes it a matter of diligent judicial endeavor to outwit one who seeks to avoid his obligations under a contract.<sup>19</sup> It will not countenance such dishonesty. It wishes to leave all parties free to contract, to hold them to such agreements. It frowns on an employee who refuses to fulfill part of the considera-

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17. *Brannen v. Bouley*, supra, note 13. *Edgecomb v. Edmonston*, 257 Mass. 12 (1926). *Putsman v. Taylor*, 1 K. B. 637. *Mason v. Provident Clothing, A. C.* 724 (1913).

18. *Supra*, note 17.

19. *Fleckenstein v. Fleckenstein*, supra, note 11.

tion for which he was hired. Yet it recognizes the unequal bargaining powers in such a relation and the possible consequent forced acceptance of restrictions.<sup>20</sup> It will refuse its judicial cooperation to an employer who seeks to enforce undue restrictions, deliberately imposed. Yet it equally withholds its aid from an employee who seeks to 'get out from under' a fair contract.

Thus it seems that this is the only possible justification for present decisions. Is it a valid one? The most weighty objection to it is the undeniable modification, if not violation, of contract law effected thereby. But public interest, always a factor entitled to consideration in deciding the validity of any contract, is peculiarly and essentially a dominant factor here. Indeed, only the intervention of such a consideration has ever been the basis of the decisions on restraints of trade or competition. We have seen that all restraints were once bad. If then, the law relents, surely it is logical in conditioning its concession on a continued conformity to that one factor which previously had impelled a holding of invalidity. The question to be decided, then, is whether the public interest in such contracts is sufficient and real enough to warrant judicial interference to modify the terms in so far as and to the extent that they injure public interests, leaving untouched whatever of the contract is not violative of such interest. It would seem, since these contracts are so pregnant with possible social and economic and political consequences, that this is so.

Is the court, in applying its conception of the public policy doctrine to disregard all contract law; or is it to be guided by it, using it as a sound basis, with only such modifications as are necessary? The courts may be liberal and broad in their decisions on divisibility. They should not disregard it. If separate restrictions occur in one contract, clearly and distinctly stated, there will be no trouble. And while it may be a hard pill to take, we may admit that if a contract states too broad a scope of limitations and also a lesser scope—e.g.—non-competition with a Newark store in Newark, in Jersey City, in New York—the court may choose to enforce only as to the Newark area, if circumstances show the others too broad. While we may

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20. See: 41 Harv. L. Rev. 782.

disagree with a construction which declares such a contract severable yet we perceive that the basis for it has been the contract principle of severability liberally and broadly interpreted because of the recognition of the public interest involved. Social factors, economic and political conditions have assumed increasing importance as elements in judicial decisions. They are the inarticulate major premises of Mr. Holmes' philosophy of law. But they should not become the sole 'ratio decidendi'. Within the scope of sound contract law there is room for the exercises of such elements of social trends and needs. So long as the law is not rigid but flexible, there is a field for change and the application of concepts arising from new or altered social or economic or political conditions. But, since any change presupposes and depends on a permanence, these changing concepts of public policy and interests are referrable, necessarily, to the unchanging contract law. This must be so, unless we choose to change fundamental contract principles.

And this is the danger indicated by some decisions on the problem of severability. Recognition of the 'new needs' has blinded some courts to the existence of old principles, so that decisions come to rest on the new changing factors with little or no attention or weight directed to the basic law. Many courts have adopted 'blue pencilling' as an aid in deciding extent of enforceability.<sup>21</sup> Originally, this meant nothing more than the striking out of severable restrictions. Gradually its use has increased. And the gradual increase has disregarded the original use, forgotten to refer 'blue pencilling' to severability. The result is the emergence of a new principle applicable to covenants of non-competition. Courts will enforce to the extent they think the restriction should be effective,<sup>22</sup> with no regard for or thought of the nature of the case before it—a contract case to be tried under applicable law. To such courts it matters not what the intent be, whether the contract be divisible, that nothing in the instrument indicates any lesser scope of application or justifies a restricted enforcement. Thus a means to the enforcement of contract

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21. See: 40 Harv. L. R. 326. *Edgecomb v. Edmonston*, supra, note 17.

22. *Peltz v. Eichele*, 62 Mo. 171. *Edgecomb v. Edmonston*, supra, note 17. *Putsman v. Taylor*, supra, note 17. *Mason v. Provident Clothing*, supra, note 17.

law has become an end. And while practically it may be desirable, yet legally it is abortive of contract principles. Justification is sought in the peculiar nature of the contract. But the very promulgation of such a justification is its negation—for while it may be of a special nature, the instrument is still a contract. And while we may admit a modification of applicable law or a 'modern' construction, no peculiarity can be a reason for disregarding that law. It is said that where disregard of the illegal provision will not defeat the primary purpose of the bargain, the contract can be enforced.<sup>23</sup> But can this mean any more than that where the illegal provision is severable and not essential to the purpose it will be stricken? Indeed, any other interpretation is destructive of the very object sought to be achieved. Public policy is said to be favorable to the enforcement of reasonable restrictions. Therefore, public policy is opposed to the inclusion of unreasonable restrictions. Public policy is said to dictate preferability for the finding of severable clauses whenever possible. But a blind and complete adherence to such a trend will inevitably produce effects opposed to more fundamental policy. For employers will include in restraining covenants clauses as comprehensive and all-inclusive as can be devised, knowing the law's tendency to 'blue-pencil' and to re-write such restrictions. He is in effect in a position where he cannot lose; if his covenant is attacked, the court will cut it down to what it thinks is reasonable; if a potential objector refrains, in the knowledge that in any event the court will not declare the contract, however viciously conceived, to be void but will 'rephrase' it, the employer is that much ahead.<sup>24</sup>

Any theory, trend or tendency which might lead to such situations is carefully to be watched. We can perceive the validity of the application of 'public policy' considerations to such contracts. It is, as was said, a legitimate and most appropriate field for its operation. But care must be had lest overemphasis of the one lead to a distortion of the whole. It is a fatal error to interpret a whole scene in terms of one factor. The law is flexible enough to allow the play of new and changing conditions. Yet if we are to retain our system

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23. A. L. I. Contracts Sec. 603.

24. 40 Harv. L. R. 326.

of law and its bases, we must realize that flexibility can logically be asserted only of that which is solidly and firmly foundationed on the unchangeable. No single factor should over-balance or out-weigh the essential and basic and applicable contract law.

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CONTRACTS—THIRD PARTY BENEFICIARY—TIME OF ACQUISITION OF INDEFEASIBLE RIGHT.—When a court of last resort in all causes emphatically states that a certain approach to the solution of a legal problem is “not the view in our State” it is, perhaps, a barren endeavor to champion ardently such an approach. And this, even though the court concedes that “there is weighty authority in support of the view” which the court rejects.<sup>1</sup> However, the endeavor will be made.

That a third party beneficiary obtains a right from a contract upon which he can sue the promisor in his own name has been established in a long line of cases in New Jersey as well as in other jurisdictions. <sup>2</sup>The confusion and conflict arises when it is sought to ascertain at what point the right becomes indefeasible in the third party beneficiary so that the conduct of promisor and promisee cannot destroy it. In spite of the recent decision referred to <sup>3</sup>the New Jersey cases present no well settled disposition of the problem.

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1. Dufford v. Nowakoski, 125 N. J. Eq. 262, 9 A 2d 302 (E. & A., 1939) in which the approach or view rejected is that a donee beneficiary acquires an indefeasible right immediately upon the making of the contract for his benefit.

2. As to simple contracts see Joslin v. N. J. Car Spring Co., 36 N. J. L. 141 (S.C., 1873). As to contracts under seal see R S. 2:26-3.6.

3. Dufford v. Nowakoski, supra note 1.

4. Crowell v. Currier, 27 N. J. Eq. 152 (Ch., 1876), affirmed in Crowell v. Hospital of St. Barnabas, 27 N. J. Eq. 650 (E. & A., 1876). The affirming opinion indicates an exception to the rule in the case of general assignments for benefit of creditors. In that case the creditors get a right of which no power of the debtor's could divest them. For the exception see also Scull v. Reeves, 3 N. J. Eq. 131 (Ch., 1834); Alpaugh v. Robertson, 27 N. J. Eq. 96 (Ch., 1876).