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Contracts (1964)

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C H A P T E R 6

Contracts

FREDERICK M. HART

§6.1. **Covenants not to compete.** In the 1961 ANNUAL SURVEY, attention was called to the large number of cases involving covenants not to compete.¹ In that year most of the litigation pitted employer against employee.² During the 1964 SURVEY year two cases in which the buyer of a business attempted to enforce a covenant not to compete are worth noting. A third case,³ decided in 1962, is also included as it provides the necessary background for one of this year's decisions.

Whether a covenant not to compete should be implied in the sale of stock was discussed at length by the Supreme Judicial Court in *Tobin v. Cody*⁴ during the 1962 term. In that case a long-established and friendly business relationship was terminated in an amicable settlement when the defendant sold the plaintiff his stock in the corporation. After six years the defendant began a competing business. The plaintiff-buyer brought an action to enjoin the defendant from competing, and the Court upheld an injunction granted below.

The Court recognized the close connection between the good will of a business and a covenant not to compete. It held that even though the good will of a corporation belongs to the corporate entity, there are situations in which the sale of stock by a stockholder carries with it a transfer of the good will. The primary test of whether a covenant not to compete should be implied is whether the covenant is necessary to give to the purchaser what was sold to him. Among the criteria to be considered in a particular case are the following: whether the seller was an active participant in the business, whether he held a position with the company that gave him the opportunity to control or affect the good will, the number of shares outstanding, and the connection between the name of the seller and the name of the business.

A similar case, *Cap's Auto Parts, Inc. v. Caproni*,⁵ was decided during the 1964 SURVEY year. The Court had little difficulty in fitting the case into the general mold of *Tobin v. Cody*. The only distinguishing

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§6.1. ¹ 1961 Ann. Surv. Mass. Law §4.3.

² *Ibid.*

³ *Tobin v. Cody*, 343 Mass. 716, 180 N.E.2d 652 (1962).

⁴ *Ibid.*

⁵ 347 Mass. 211, 196 N.E.2d 874 (1964), also noted in §5.7 *supra*.

factor was that in *Cap's Auto Parts* the circumstances surrounding the sale of stock were distinctly unfriendly, and the settlement had an undercurrent of bitterness. The Court did not attach any significance to this difference, but it does seem to be of importance. When a settlement is friendly, it may well be that the buyer reasonably assumes that the seller will not compete with him and that the law should find an implied-in-fact promise by the seller to that effect. When, however, the transaction is marked by hard bargaining, it is more reasonable to expect that the covenant not to compete would have been extracted from the seller if this had been part of the deal. The Court in *Cap's Auto Parts* did note that the seller indicated his intention to retire, and it may be that this finding gave rise to the implication of the covenant.

*Sulmonetti v. Hayes*⁶ marks the furthest that the courts have gone in allowing an injunction to run against strangers to a covenant not to compete. Frank Hayes operated a fuel oil business with his father and continued the business after his father's death. His wife Emily actively assisted Frank in the office after the death of his father. The business floundered, and Frank sold out to Sulmonetti, a separate consideration of \$10,000 being paid to Frank for his covenant not to compete. Emily was not a party and may not have known of the covenant before it was actually signed. Two years later Emily formed an oil company under a new name. She was the sole stockholder, president, and treasurer. Emily, even when she had worked for the prior business, had shown considerably more business acumen and capability than Frank. The Court found that Frank "deliberately and willfully" connived with Emily, although exactly what form this "connivance" took is not indicated. On suit by the vendee to enforce the covenant specifically the Supreme Judicial Court had no difficulty in enjoining Frank from activity breaching his covenant, but Emily presented a different situation.

The evidence did not bring the case within the recognizably enjoinable conduct of strangers to the covenant, such as when the vendor uses the third person as an agent, or the third person is the vendor in colorably altered form, or the third person induces the vendor to breach his covenant.⁷ The Supreme Judicial Court, however, rested its affirmance of the injunction on the "deliberate and willful" connivance with Frank. Invoking the basic principle of fair dealing with a vendee, the Court found Emily's conduct to be in derogation of the good will that the vendee had purchased.

§6.2. Liquidated damages. When a contract provides that a defaulting party shall pay the entire price as damages, this has the mark of a penalty clause.¹ This is especially true when the circumstances make it impossible or impractical for the breaching party to accept

⁶ 1964 Mass. Adv. Sh. 693, 198 N.E.2d 297, also noted in §5.7 *supra*.

⁷ See *Moran v. Dunphy*, 177 Mass. 485, 59 N.E. 125 (1901).

§6.2. ¹ McCormick, *The Law of Damages* §149 (1935).

the bargained-for benefit. *Daley v. J. F. White Contracting Co.*,² decided during the 1964 SURVEY year, is an interesting variant to this general rule.

In the *Daley* case the defendant agreed to take 100,000 yards of "borrow and fill" from the plaintiff's land during a twenty-month period and to leave the property graded. The defendant was to pay \$15,000 for this right. The contract also provided that "in the event that . . . [the defendant] has not removed the 100,000 yards, he shall then pay for said amount . . . and be allowed an extra month to remove it after the expiration of the agreement." The defendant removed considerably less than the total amount of fill to which he was entitled, and he failed to grade the land properly.

The plaintiff sued for the entire purchase price plus an amount that would compensate him for the expense of grading. The defendant argued that to allow the plaintiff to recover the entire price would be to enforce a penalty clause, and that he was liable only for the difference between the contract price and the reasonable value of the fill that he did not take. The Supreme Judicial Court held that even if this were the proper measure of damages in the absence of a contractual provision to the contrary, the parties had the right to agree as to the measure of damages provided that no penalty was involved. The Court then held that this was not the ordinary case in which the loss to the plaintiff was only the difference between the contract and market price. Here the plaintiff had given up his right to sell the gravel to anyone else for a period of twenty months, and he had also allowed the defendant to install and store equipment on his land for the purpose of removing the gravel.

§6.3. Arbitration. In a case of first impression under Sections 2 and 3 of the Uniform Arbitration Act,¹ the Supreme Judicial Court indicated the necessity of strict compliance with both the statute and a contractual provision providing for the appointment of an arbitrator. The plaintiff in *Roberto Construction Co. v. Burnham-Manning Post #1105, Veterans of Foreign Wars*² moved that an arbitrator be appointed to determine the merits of its claim under a construction contract. The contract provided that any disputes arising under the contract should be submitted to arbitration upon the written demand of either party. Under the provisions of the Standard Form of Arbitration Procedure of the American Institute of Architects, which was incorporated into the contract, each party was to appoint one arbitrator and the two so appointed were to appoint a third.

The trial judge ordered that the parties proceed to arbitration, and he appointed an arbitrator. In reversing, the Supreme Judicial Court held that Section 2(a) of the Uniform Act, which gives the court authority to order arbitration, was inapplicable since the plaintiff had

² 347 Mass. 285, 197 N.E.2d 699 (1964).

§6.3. ¹ G.L., c. 251, §§2, 3.

² 1964 Mass. Adv. Sh. 705, 198 N.E.2d 302.

failed to comply with the conditions giving him a right to arbitration, and the defendant had not refused to arbitrate the matter. The Court also stressed the importance of Section 3 of the act which provides that when the agreement provides a method of appointment of arbitrators the agreed upon method should be followed unless it fails. Implicit in the Court's holding is the requirement that if the order to proceed to arbitration had been proper, the parties should have been given an opportunity to select a board of three arbitrators under the provisions of the contract instead of being forced to accept the one arbitrator appointed by the lower court.

§6.4. Statute of frauds: Interest in land. Each year a significant number of cases involve the statute of frauds. Most of them are routine. None require resort to basic theory. A few, however, do present exercise for the legal gymnast and provide an opportunity either to broaden or to narrow the effect of the statute. One case, *First National Bank of Boston v. Fairhaven Amusement Co.*,¹ is interesting or dull depending upon how its facts are read.

The defendant had orally agreed to bid at a judicial foreclosure sale for "personal property on which the plaintiff held a chattel mortgage and for the interest in a ten-year lease of real estate which had been assigned to the plaintiff." The defendant repudiated its obligations, the sale was made to a third party, and the plaintiff sued for damages. The defendant pleaded the statute of frauds, and the trial court directed a verdict on the ground that the contract concerned an interest in land and was within the statute. The plaintiff's main contention on appeal was that the statute of frauds should not apply to a judicial sale. The Supreme Judicial Court correctly refused to answer this argument on the ground that even if this were true, the exception would not cover this case as the alleged contract was made preliminarily to and not at the judicial foreclosure. A contract to bid at a judicial sale is not itself under the supervision of the court and is covered by the statute if within one of its sections.

The more interesting aspect of the case is obscured by the ambiguity in the Court's description of the contract terms. It is not clear whether the plaintiff was to transfer the lease to the defendant as a separate transaction or whether the defendant was to bid for the lease at the judicial sale and take the assignment from, or at least through, the court. The more reasonable interpretation of the facts is that the lease was to be sold by the court along with the personal property.² If this is true the case stands for the proposition that an agreement to bid for land at a sale is a contract for "the sale of lands . . . or of any interest in or concerning" land. In effect, the Court held that a promise to make an offer to purchase land is the equivalent of a "contract for sale" of land.

In view of the fact that the legislature believes that society is bene-

§6.4. 1 347 Mass. 245, 197 N.E.2d 607 (1964), also noted in §2.3 *supra*.

² This point is not made clearer by examination of the record or the briefs.

fit by invalidation of oral contracts for the sale of land, the Court's decision is correct. A promise to offer to purchase land, although technically distinct from a contract to purchase land, seems no less likely to breed fraud.