This paper is designed to provide a refresher regarding legal issues that are impacted by public policy and that have an effect on business. Public Policy is often times difficult to define but may be derived from the various sources of American law. The application of public policy permeates the various areas of substantive business law, including but not limited to contracts, employment situations, covenants not to compete and business organizational practice. It is determined and often defined by constitutions, legislative enactments, judicial decisions and the common law. The derivation of the public policy in question may depend upon the facts of the case and the state in which it occurred.

I. INTRODUCTION

Public policy has a significant impact on the development of the law and its application has and continues to have an impact on many substantive areas, including, but not limited to, contracts, employment issues, business practices and covenants not to compete. Legal matters involving public policy should not only express the norms of society and represent public standards but should also consider the protection of the public. Public policy determinations are very strongly weighted in protecting the public at large rather than the particular individual in a specific factual situation. Public policy should also be consistent in expressing the norms of society as set-forth within the various sources of our law. However, it is unique in that its effect and application is also reflective of changes in societal norms when necessary. The question often presented is which branch
of the government can be the most responsive to change within a sometimes limited frame of time. The change may be first introduced directly through the judiciary with the legislative branch to soon follow. The legislature may not agree with the judicial interpretation and application of the policy and therefore enact legislation which reflects its view. The legislative view may have the effect of overturning the court’s decision or follow it and therefore codify the ruling into a statute. Technological advances, medical breakthroughs and a change in societal norms are just a few examples of these changes that are subsequently reflected in state statutes, constitutions and their amendments and/or judicial determinations.

Public policy is often tossed around in the world of academia as if it is a catch all for everything that isn’t specifically included and addressed by the other sources of American Jurisprudence. To a certain degree this statement is not far from being accurate, however, it does diminish the importance of the role that public policy can play as a result of legislative enactments and more specifically decisions rendered by the judiciary. Indeed, there are cases in which the only argument that remains to be made on behalf of the party is solely based on public policy. The changes may begin in most any branch of our government and either be affirmed or modified by another branch. For example, a judicial decision may, in fact, be modified or overturned by a subsequent statutory enactment. The determination as to where the public policy is first established largely depends on the responsive nature of each branch of government to the issue or the will of the people. All three branches of government are involved in a variety of ways in the identification, development, application and interpretation of public policy.
THE DEFINING OF PUBLIC POLICY THROUGH A VARIETY OF SOURCES

Jurists differ on the origin.

“The resolution of questions of policy is addressed in a democracy to the policymaking branch of government, the General Assembly, and it is not for the courts to make a statute say something that it clearly does not.”¹

HOWEVER

“...an exception to the employment-at-will doctrine is not limited to public policy expressed by the General Assembly in the form of statutory enactments. As this court recently noted, ‘(w)hen the common law has been out of step with the times, and legislature, for whatever reason, has not acted, we have undertaken to change the law, and rightfully so. After all, who presides over the common law but the courts?’”²

As previously set-forth, the numerous sources of American law may each have their own individual effects on public policy depending on the factual situation that is presented. The sources may include: Constitutions, Statutes, Case law and Common law, Administrative law and rules regarding professional responsibility of various professions. It appears that the primary source of policy comes from each state’s respective legislatures. However, this supposition turns on which state and court are reviewing the case. In Building Services Intern. v. Gazzam³ the
Court opined: “The public policy of any state is to be found in its constitution, acts of the legislature, and decisions of its courts. ‘Primarily it is for the lawmakers to determine the public policy of the state.’”

The common law formed the basis of much of our early American law and had a significant impact on the evolution of our legal system as it relates to various societal concerns and interests. Much of the common law has been incorporated into the statutory schemes of the various states. It can be argued that the incorporation of the common law into state statutes removes a certain degree of discretion regarding policy decisions that might otherwise be determined by the judiciary, even though the interpretive aspect of our legal system is still firmly rooted in our court decisions. When legislation is present, the judiciary simply utilizes its interpretative responsibilities of the law and makes its application to a specific factual situation. Furthermore, there are commentators who strongly believe that this process is more reflective of the will of the people and develops decisions that are in the best interest of the public at large. However, with public policy lacking complete codification it becomes necessary for the courts to apply their own understanding of the public’s welfare. Public policy may be determined by judicial decisions when it is not found in the State’s constitution and statutes.

Justice Burrough, in Richardson v. Mellish, expressed his thoughts and concerns regarding the judicial development of public policy when he cautioned that public policy is:

“(public policy is) a very unruly horse and when once you get astride it you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail.”
In addition to the statutes and court decisions, public policy has also been derived from Codes of Professional Conduct. The court noted in *Rocky Mt. Hosp. & Medical Service v. Mariani*\(^7\) that an ethical code may form the basis for public policy provided that it is clear regarding the conduct that is acceptable or unacceptable, the policy benefits the public rather than the profession or individual involved in the issue and that the court balances the public interest with the need of a business to make a decision.

An accountant asserted that a portion of the professional code in Colorado prevented her from following the request of a superior in her position as an in-house employee. The accountant refused to follow the superior’s instructions because of her concern regarding a violation of the professional code. The accountant was an at-will employee and argued that the termination from employment was, in part, due to her refusal to follow the superior’s instructions. The defense that was presented on behalf of the accountant was that the conduct that the superior directed would be against the professional conduct code and therefore, potentially, subject her to disciplinary action. The issue that was presented to the court regarding public policy was that an individual should not be placed in a position of being subjected to discipline or lose their job. The court found that there was a viable argument presented that a professional should not be placed in this position, especially when the conduct might have an effect on the public. While ethical codes may form and define the basis of public policy they are not to be a blanket endorsement. The codes must be explicit enough at defining policy that protects the public as a whole. It is important to note that not all professional codes or provisions thereof, establish public policy.
An additional consideration in determining whether professional codes and other sources should be considered or utilized as public policy is the degree of input the public has regarding the particular decision maker. Those who develop professional codes are often political appointees. The argument may be made that the board or commission making the rules are therefore insulated from public pressure while the other side of the argument may claim that those individuals determining what is best for society, through the identification of the norms, should be more accountable to the public. Certainly there is accountability with various state legislatures and in many states regarding an elected judiciary.

Defining public policy is sometimes a difficult task and indeed can vary from state to state. In Petermann v. International Brotherhood of Teamsters, the California court stated, "The term 'public policy' is inherently not subject to precise definition." It has been characterized as vague yet few cases arise that in which its application in some manner may not be disputed.

Commentators, such as Mr. Story in his work on Contracts (§ 546), comments:

"By ‘public policy’ is intended that principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public or against the public good....Public Policy means...anything which tends to undermine the sense of security for individual rights, whether of personal liberty or private property, which any citizen ought to feel is against public policy...”

Professor Story certainly recognized the challenge in the utilization of public policy while extolling its' virtues.
Public policy has come to the rescue of many at will employees that have been terminated because of their refusal to violate a law or administrative regulation and subsequently were terminated from their employment based upon such activity. The plaintiff, in Petermann, supra, was terminated from his employment for refusing to perjure himself during an investigative hearing before the Legislature. Peterman was terminated for not following the instructions of the employer. The Court of Appeals in its reversal of the trial court stated: “It would be obnoxious to the interests of the state and contrary to public policy and sound morality to allow an employer to discharge an employee ... on the ground that the employee declined to commit perjury.” Employment at will cases take on the cause of action of retaliatory discharge or wrongful discharge. The court recognized a wrongful termination in Petermann when it noted that Penal Code section 118, prohibiting perjury, derives from the general principle that “the presence of false testimony in any proceeding tends to interfere with the proper administration of public affairs and the administration of justice.” Therefore, the case addressed an issue that specifically effect’s the public although it addressed the fact situation of one employee.

"There is no precise definition of the term. In general, it can be said that public policy concerns what is right and just and what affects the citizens of the State collectively. It is to be found in the State's constitution and statutes and, when they are silent, in its judicial decisions. [Citation omitted] Although there is no precise line of demarcation dividing matters that are the subject of public policies from matters purely personal, a survey of cases in other [s]tates involving retaliatory discharges shows that a matter must strike at the heart of a citizen's social rights, duties, and responsibilities before the tort will be allowed." As
previously mentioned, statutes may form the basis of a public policy issue. In Palmateer, supra, the court set-forth the following regarding statutory matters that resulted in public policy cases:

“Petermann v. International Brotherhood of Teamsters Local\textsuperscript{14} (for refusing to commit perjury); Tameny v. Atlantic Richfield Co.\textsuperscript{15} (for refusing to engage in price-fixing); Harless v. First National Bank\textsuperscript{16} (for refusing to violate a consumer credit code); O’Sullivan v. Mallon\textsuperscript{17} (for refusing to practice medicine without a license). It has also been allowed where the employee was fired for refusing to evade jury duty (Nees v. Hocks\textsuperscript{18}; Reuther v. Fowler & Williams, Inc.)\textsuperscript{19}, for engaging in statutorily protected union activities(Glen v. Clearman’s Golden Cock Inn, Inc.)\textsuperscript{20}, and for filing a claim under a worker’s compensation statute (Sventko v. Kroger Co.\textsuperscript{21}; Frampton v. Central Indiana Gas Co.\textsuperscript{22}). “

In addition to professional codes of conduct, administrative regulations may form the basis for a plaintiff to argue public policy. In Jasper v. Nizam\textsuperscript{23}, the plaintiff had been a supervisor at a private child care facility. A state regulation provided for a specific ratio of workers to children at all facilities in Iowa. The owner of the facility was interested in cutting costs and suggested a work force reduction. The owner directed the plaintiff to adjust the number of employees down to stated specifications not the states. The plaintiff informed the owner that a reduction in employees would violate state regulation in the industry. The owner was aware of the ratio yet insisted that the employee’s comply with his direction. The plaintiff, an employee at will, was ultimately terminated from her
employment for, at least in part, her refusal to violate the administrative regulations.

The court in analyzing the issue of this case utilized the following criteria:

1. Whether there is in existence a clearly defined public policy that protects the employee’s activity.

2. Whether the public policy would be jeopardized by the discharge of the employee from employment.

3. Whether the employee engaged in the protected activity and this conduct was the reason for the employee’s dismissal.

4. Whether there was an overriding business reason for the termination.

As would be expected, the court did not seem to have difficulty in concluding that the regulation protected the children of the state and that anyone who sought to violate such a policy would be subject to the courts finding. The defendant countered that a state regulation should not be the source of a court finding a public policy that would result in the award of damages to a discharged employee given the vast number of state regulations and their alleged lack of reliability. Court’s seem to be hesitant to interject their opinion into business decisions and in particular when public policy is involved. However, if the conduct has an adverse effect on the public at large and especially children the courts do not hesitate to act.
The Indiana Supreme Court in *Straub v. B.M.T.* stated: “Where public policy is not explicit, we look to the overall implications of constitutional law and statutory enactments, practices of officials and judicial decisions to disclose the public policy of this State. (Citation omitted) Where there is not a clear manifestation of public policy we will find an agreement void only if it has a tendency to injure the public, is against the public good or is inconsistent with sound policy and good morals (citation omitted).”

Some agreements are specifically prohibited by statute and others are even outlawed based upon court rules such as Indiana’s rule against contingency fees in criminal cases as set forth in Indiana’s Professional Conduct Rule 1.5(d) (2).

A balancing test is employed in some situations involving public policy. In Florida the court used a balancing test in regard to the definition and subsequent enforcement of certain contracts in reference to public policy. In *Miller Mechanical v. Ruth* the court balanced the legitimate interest of the promise against the hardship of the promisor and secondly, the injury to the public in order to determine the permissible scope of a restraint. When the policy is defined or set forth in the state constitution or statutes the courts role turns into a more traditional role of simply interpreting the statute. With regards to contracts it is up to the court alone to decide whether contravention of public policy is grave enough to warrant unenforceability.

According to Professor Farnsworth, supra, at 324, “... in a doubtful case the court’s decision must rest on a delicate balancing of factors for and against enforcement of a particular agreement. Enforcement should not be refused unless the judicial process outweighs the factors favoring enforceability.
“Whatever is injurious to the interests of the public is void, on the grounds of public policy.”

In Harper v. Healthsource New Hampshire, Inc. An agreement is against public policy if it is injurious to the interest of the public, contravenes some public statute, is against good morals, tends to interfere with the public welfare or safety, or, as it is sometimes put, if it is at war with the interests of society and is in conflict with the morals of the time.” Professor Farnsworth attributes the basis of public policies to a number of a variety of sources. He asserts that they are based on the impairment of family relationships, moral values, gambling and economic issues such as restraint of trade and the alienation of property. Others come from an effort to protect governmental institutions, “as do the policies against encouraging litigation” and “those improperly influencing legislators and other government officials.”

In Thomas James Associates Inc. v. Jameson an employee executed an employment contract that waived his right to arbitration. Jameson waived his arbitration right in an employment agreement that the court found to be void as against public policy. The waiver was prohibited by 52 Fed. Reg. 9232 (1987) and was in violation of Article III, section 1 of the NASD’s Rules of Fair Practice.

“When a self-regulatory association of securities firms, under direct federal supervision, ordains that its members may not require their employees to waive arbitration rights, it would be inappropriate for us to enforce such a waiver.”

In citing Stamford Bd. Of Educ. V. Stamford Educ. Ass’n, the court commented on the wide range of areas that are addressed by public policy: “The term public policy is obviously a broad one; it embraces a multitude of virtues and sins.”
Federal “public policy” is typically found in the Constitution, treaties, federal statutes and regulations, and court cases. And: while violations of public policy must be determined through definite indications in the law of the sovereignty, courts must not be timid in voiding agreements which tend to injure the public good or contravene some established interest of society.”

Indeed, valid contracts are agreements between two or more individuals or entities that are enforceable in a court of law or equity. The difficulty in determining a contract to contravene public policy is found in the volitional act of the parties to enter into the agreement. Contracts addressing a variety of issues are sometimes subject to public policy scrutiny. If the contract has a negative impact on society it is subject to the scrutiny. Some involve business and others are much more personal in nature. The following addresses areas of business that public policy may work to invalidate an otherwise valid contact.

“One of the oldest and best established of the policies developed by courts is that against restraint of trade.”31 Contracts that may have an effect on the free flow of trade and competition in the market place are carefully scrutinized by the courts and in fact, there are states that have addressed the trade issues by statutes. Although restrictions of trade and commerce are prohibited not only by case law there are also restrictions placed on these types of contracts by statutes. However, there are certain exceptions that may be made by the courts. Contracts that restrict an employee subsequent to departing a previous employment and restrictions on individuals who sell businesses may be the basis of some of these exceptions provided they follow the parameters set-forth in the law. These are often referred to as a covenant not to compete or restrictive covenant. This
restraint may arise either in the sale of a business or the employment contract of an individual.

In the sale of a business the purchaser will often insist on a contractual clause that prohibits the seller from opening a new business, especially one related to the business that is sold. The courts have found these types of contractual clauses acceptable as an exception to the issue of restraint of trade. These types of matters often turn on the specific facts contained in the agreement. To fit the exception most courts have found that the restriction must be reasonable in time and in geographical area. The basis of the exception is to protect the purchaser’s receipt of the goodwill and reputation of the business. The clause must also be ancillary to a sales agreement or it will be void because it unreasonably restrains trade and would be contrary to public policy.

“In applying this rule of reason to promises to refrain from competition Courts have fashioned a requirement of ancillarity. To serve an interest of the promise that is worthy of protection and that can outweigh the hardship to the promisor and the injury to the public, the restraint that the promise imposes must be ancillary to an appropriate transaction or relationship. A direct or non-ancillary restraint serves no such interest and is necessarily unreasonable. The promise that imposes the restraint is therefore unenforceable per se.” 32 The reasoning for the restriction cannot go any further than necessary to protect the former employer’s legitimate business interest. The courts will scrutinize these agreements very closely and insure that the restriction is not imposed to harass or is overly broad.
Public policy may be found in a variety of our sources of law. There is little doubt that the business environment is effected by the interpretations that our system places on them through the application of public policy that will operate to protect the public.

**sources**


7. *Rocky Mt. Hosp. & Medical Service v. Mariani, 916 P2d 519 (1996 Colo.)*


9. *as cited in Safeway Stores v. Retail Clerks etc. Assn., 41 Cal. 2d 567, 575*
10 Safeway Stores, supra at 575 as cited in Petermann, supra at 188

11 Petermann at 188-189, cited in Stevenson v.The Superior Court of Los Angeles County, 16 Cal. 4th 880(1997)

12 Petermann at p. 188


15 Tameny v. Atlantic Richfield Co. (1980), 27 Cal.3d 167


18 Nees v. Hocks (1975), 272 Or. 210


22 Frampton v. Central Indiana Gas Co. (1973), 260 Ind. 249

23 Jasper v. Nizam


24 Miller Mechanical v. Ruth, 300 So. 2d 11 (1974)

25 Horner v. Graves (1831) 7 Bing (Eng) 735,775; 140 N.H. 770, 674 A.2d 962,965


27 Farnsworth at 327

28 Thomas James Associates Inc. v. Jameson, 102 F.3d 60 (2d Cir. 1996)


Farnsworth, supra at 331

Farnsworth, supra, at 332, citing JAK Prods. v. Wiza, 986 F.2d 1080 (7th Cir. 1993) in part.