

Protecting Competitive Business Interests Through Non-Compete Clauses: What Interests Can Legitimately Be Protected?

By Ryan S. Bewersdorf and Nicolas J. Ellis

Introduction

Today more than ever before, employment agreements tend to contain some form of non-competition provisions. For higher-level executive employees, such provisions are virtually ubiquitous. These provisions are also creeping into medical profession employment agreements. As the economy improves and hiring increases, more employees will be able to change jobs. As that happens, a new wave of non-compete litigation likely will result. Thus, employers should assess their current non-compete agreements, and when hiring employees, carefully draft new non-compete agreements to make sure they can withstand judicial scrutiny in the event litigation occurs. Any employer seeking to include a non-compete in its employment agreements would be well advised to consider the rules that govern enforcement of such provisions. In Michigan, the enforceability of a non-compete agreement between an employer and employee is governed by statute.¹ In addition to codifying the traditional rule that such agreements must be reasonable, the statute also requires that the agreement must protect “the reasonable competitive business interests” of the employer. This article will address the way courts have interpreted this requirement, and the kind of interests that fall within its scope.

A Brief History Of Non-Compete Agreements Under Michigan Law

Michigan initially followed the general common law rule that non-compete agreements were enforceable as long as they were reasonable.² However, between 1905 and 1985, non-compete agreements were prohibited by statute as an illegal restraint of trade.³ In 1985, the Michigan Anti-Trust Reform Act (“MARA”) repealed the statutory provision that specifically prohibited non-compete agreements.⁴ After this repeal, the gen-

eral antitrust provisions of the MARA were interpreted as prohibiting only those agreements that were unreasonable restraints on trade, essentially returning to the traditional common law rule.⁵ In 1987, the legislature amended the MARA such that it specifically permits the use of non-compete agreements between an employer and employee under certain conditions.⁶

MARA’s Noncompetition Provision

Today, non-compete agreements between an employer and employee are governed by MCL 445.774a(1), codifying the 1987 amendment to the MARA. This statutory provision provides that:

An employer may obtain from an employee an agreement or covenant *which protects an employer’s reasonable competitive business interests* and expressly prohibits an employee from engaging in employment or a line of business after termination if the agreement or covenant is reasonable as to its duration, geographical area, and the type of employment or line of business. To the extent any such agreement or covenant is found to be unreasonable in any respect, a court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited (emphasis added).

The statute imposes two requirements for a non-compete to be enforceable.⁷ The latter part of the statute incorporates the traditional common law model based on determining the reasonableness of the non-compete with respect to its geographic scope, duration, and the scope of employment that is covered.⁸ However, the first part of the statute further restricts the enforceability of non-compete agreements to those that protect an

employer's "reasonable competitive business interests."⁹

But what is a reasonable competitive business interest? While the Michigan Supreme Court has not provided an extensive definition for this term, a fairly comprehensive picture can be drawn by analyzing other decisions made by the lower Michigan courts.

Interpretation of "Reasonable Competitive Business Interests" By the Courts

The best way to understand how courts have interpreted the term "reasonable competitive business interest" is to begin with what it does not cover. Contrary to what many people might expect, the term does not include merely protecting the employer from general competition.¹⁰ Courts have consistently held that employers do not have an interest in preventing employees from competing through the use of general knowledge, skill, or facility acquired by the employee through training or experience during employment.¹¹

To protect a reasonable competitive business interest, a non-compete agreement must protect against the employee (or presumably a competitor through hiring the employee) gaining an *unfair advantage* in competing with the former employer.¹² The term "unfair" is itself somewhat subjective and ambiguous. To date, courts have either recognized, or spoken of, three different categories where employers have an interest in protecting themselves from unfair competition:

- preventing employees from taking existing customers,¹³
- preventing an employee from using confidential information,¹⁴ and
- protecting an employer's investment in *specialized* training.¹⁵

Existing Customers

The courts' unfair competition concern with regard to taking existing customers is that the employee has generally developed a relationship with the customer through his or her position as an employee. Often, an employer has invested its resources in developing, or helping the employee develop, the relationship.¹⁶ Courts speak of this as preventing the employee from appropriating the "goodwill" that the employer has built.¹⁷ In *St Clair Med v Borgiel*, the court addressed the enforceability of a non-compete agreement between a physician and his former employer.¹⁸ The court determined that the non-compete agreement

protected the employer's reasonable competitive business interest because a physician who establishes patient contacts and relationships as a result of the goodwill of an employer's medical practice is in a position to unfairly appropriate that goodwill, and thus unfairly compete with a former employer on departure.¹⁹ Enforcement of the non-compete agreement provides the employer with time to regain the goodwill of its patients and prevents former employees from using contacts gained during employment to gain an unfair advantage in competition.²⁰ Similarly, in *Radio One, Inc v Wooten*, the court considered a non-compete agreement between a radio personality and his former employer radio station.²¹ The court made an analogy to the *St Clair Med* case, and noted that, despite the defendant's pre-existing fame, the radio station had built listener goodwill through its efforts and expenditures to promote the defendant, and it was entitled to a period of time to promote a new radio personality to try to retain its listeners and sponsors.²²

Confidential Information

Courts consider confidential business information to cover a range of topics related to the running of a business. In particular, courts have stated that employers have an interest in protecting such confidential information as pricing schemes, price markups, marketing strategies, and sales strategies or techniques.²³ They also have recognized an interest in protecting patient or customer lists.²⁴ However, the confidential information in question must actually provide a competitive advantage. Between 2007 and 2008, federal courts addressed the same identical non-compete clause between Kelly Services, Inc. and three different former employees. The court upheld the clause against two higher level employees who accepted similar positions with competitors.²⁵ However with regard to a lower level employee, then performing clerical work for a competitor, the court held that the clause did not protect the employer's reasonable business interests because the information the former employee had access to was of no use, and provided no competitive advantage, in her new role.²⁶

Specialized Training

The last area where courts have acknowledged a reasonable competitive business interest on the part of employers, protecting an investment in specialized training, remains poorly defined. Courts have con-

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sistently stated that preventing an employee from competing through the use of *general* training is not a reasonable competitive business interest.²⁷ This is true even where the on-the-job training has been extensive and costly.²⁸ They have, however, indicated that this may not be the case where *specialized* training is involved.²⁹ Unfortunately, there have not yet been any decisions under Michigan law that address the difference between general and specialized training. Thus, this factor of the “reasonable competitive business interests” test remains unsettled.

Conclusion

When drafting a new non-compete agreement or assessing a current one, an employer must consider not only the reasonableness of the restrictions it is imposing, but exactly what interest it is seeking to protect. The interests that are involved will usually depend on the facts of the situation, and to some degree will depend on the yet unknown capacity in which the employee will seek to compete. While courts have recognized a reasonable competitive business interest in: (1) protecting existing customers, (2) confidential information; and (3) specialized training, no Michigan court has clearly addressed what constitutes specialized training. Therefore, focusing on the two interests of protecting existing customers and confidential information will usually be the most straightforward way for an employer to satisfy the reasonable competitive business interest test under Michigan law. Employers should consider setting out the specific competitive business interests it is trying to protect within the non-compete agreement itself. While this is especially important where the agreement will be applied to lower level employees for whom an employer’s interest may not be as readily apparent, it should also be done for upper level employees. The potential harm resulting from an upper level employee turning into a competitor is often much greater than where a lower level employee is involved. It may be easier to show a reasonable competitive business interest where upper level employees are concerned, but setting out these interests ahead of time for all non-compete agreements can save on discovery and other litigation expenses later. Above all, in order to satisfy the reasonable competitive business interest test, employers should always be prepared to show an interest beyond merely insulating themselves from general competition.

NOTES

1. In contrast, non-compete agreements in most other situations, such as the purchase of a business, are governed solely by common law principles, however similar these may be. See *Bristol Window & Door, Inc v Hoogenstyn*, 250 Mich App 478, 495, 650 NW2d 670 (2002).
2. *Bristol Window & Door*, 250 Mich App at 489.
3. Former MCL 445.761.
4. *Bristol Window & Door*, 250 Mich App at 492-93.
5. *Compton v Joseph Lepak DDS, PC*, 154 Mich App 360, 366, 397 NW2d 311 (1986).
6. MCL 445.774(a)(1).
7. *Kelly Servs v Eidnes*, 530 F Supp 2d 940, 950 (ED Mich 2008).
8. MCL 445.774(a)(1).
9. *Id.*
10. *St Clair Med, PC v Borgiel*, 270 Mich App 260, 266, 715 NW2d 914 (2006) (citing *United Rentals (North America), Inc v Keizer*, 202 F Supp 2d 727, 740 (WD Mich 2002)).
11. *St Clair Med*, 270 Mich App at 266; *Kelsy-Hayes Co v Maleki*, 765 F Supp 402, 406-07 (ED Mich 1991), *vacated pursuant to settlement* 889 F Supp 1583.
12. *St Clair Med*, 270 Mich App at 266 (citing *Follmer, Rudzewicz & Co, PC v Kosco*, 420 Mich 394, 402 n 4, 362 NW2d 676 (1984)).
13. *St Clair Med*, 270 Mich App at 266; *Radio One, Inc v Wooten*, 452 F Supp 2d 754, 758-59 (ED Mich 2006); *Edwards Publns, Inc v Kasdorf*, No 281499, 2009 Mich App LEXIS 109, *10-13 (Jan 20, 2009) *see also Neocare Health Sys, Inc v Teodoro*, No 255558, 2006 Mich App LEXIS 240, *6 (Jan 26, 2006) (assessing whether period of five years reasonably protected “plaintiff’s legitimate business interest in protecting its patient base.”).
14. *Rooyakker & Sitz, PLLC v Plante & Moran, PLLC*, 276 Mich App 146, 158, 742 NW2d 409 (Mich App 2007); *St Clair Med*, 270 Mich App at 266-67; *Eidnes*, 530 F Supp 2d at 950; *Whirlpool Corp, v Burns*, 457 F Supp 2d 806, 812 (WD Mich 2006).
15. *St Clair Med*, 270 Mich App at 266.
16. *Radio One*, 452 F Supp 2d at 758-59.
17. *St Clair Med*, 270 Mich App at 268.
18. *Id.* at 262-63.
19. *St Clair Med*, 270 Mich App at 268 (citing *Weber v Tillman*, 259 Kan 457, 467-469, 913 P2d 84 (1996); Berg, *Judicial Enforcement of Covenants not to Compete Between Physicians: Protecting Doctors’ Interests at Patients’ Expense*, 45 Rutgers LR 1, 17-18 (1992)).
20. *St Clair Med*, 270 Mich App at 268.
21. *Radio One*, 452 F Supp 2d at 756.
22. *Id.* at 759.
23. *Eidnes*, 530 F Supp 2d at 950; *Kelly Servs, Inc v Noretto*, 495 F Supp 2d 645, 657 (ED Mich 2007).
24. *St Clair Med*, 270 Mich App at 266-677; *Godlan, Inc v Greg Whiteford & DCL, Inc*, No 227696, 2003 Mich App LEXIS 610 (Mar 11, 2003).
25. *Eidnes*, 530 F Supp 2d 940; *Noretto*, 495 F Supp 2d 645.
26. *Kelly Servs v Green* 535 F Supp 2d 180, 185-86.
27. *St Clair Med*, 270 Mich App at 266; *Kelsy-Hayes Co*, 765 F Supp at 406-07.
28. *Follmer, Rudzewicz & Co, PC v Kosco*, 420 Mich 394, 402 n 4, 362 NW2d 676.
29. *St Clair Med*, 270 Mich App at 266-67.



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