

Noncompete Agreements Under Michigan Law

While Employee Noncompetes Must Be Reasonable, Even Unreasonable Commercial Noncompetes May Be Valid

By **Dennis M. Haffey** and **James F. Hermon**

The Michigan Supreme Court recently dispelled the common misperception that “reasonableness” is the test for the validity of all noncompete agreements. Reasonableness is the test only for employee noncompetes, while commercial noncompetes are invalid only if they fail the antitrust “rule of reason.”¹

As a practical matter, few noncompetes violate the more exacting antitrust rule of reason, which requires an adverse impact on competition in the relevant market, not just an unreasonable impact on a contracting party. The typical commercial noncompete (with sellers of a business, independent contractors, distributors, dealers, and franchisors) may be enforceable even if unreasonable to a contracting party.

By contrast, employee noncompetes in Michigan must be reasonable, e.g., limited to the duration, geography, and scope necessary to protect the employer’s legitimate competitive interest. Drafting an enforceable employee noncompete is a challenge. Using forms is ill-advised. The agreement should be customized to the particular employee(s) and the employer’s interest being protected.

Commercial noncompetes are governed by the antitrust rule of reason, not by the employment reasonableness test

In *Innovation Ventures, LLC v Liquid Manufacturing, LLC*,² the Michigan Supreme Court held “that a commercial noncompete provision must be evaluated for reasonableness under the rule of reason.”³ The trial court and the Court of Appeals had held that a noncompete between businesses was governed by the reasonableness test for employee noncompetes. The Supreme Court reversed, holding:

The Court of Appeals erred by applying the standard articulated in MCL 445.774a, which is the proper framework to evaluate the reasonableness of noncompete agreements between employees and employers. Instead, the Court should have applied the rule of reason to evaluate the parties’ noncompete agreement.⁴

The Court explained that commercial noncompete agreements are governed by MCL 445.772—the general contract



Fast Facts:

Different tests govern employee versus commercial noncompetes.

Commercial noncompetes can be valid even if unreasonable.

Even an unreasonable commercial noncompete can be enforceable, as long as it does not violate antitrust law.

An agreement not to compete buried in an employee handbook risks being unenforceable. Handbooks are not always signed by employees and often contain disclaimers stating that they are not contracts but mere expressions of policy that can be unilaterally changed by the employer.

provision of the Michigan Antitrust Reform Act—and that “MCL 445.772 codified the rule of reason” by its language modeled on the federal Sherman Antitrust Act: “A contract, combination, or conspiracy between 2 or more persons in restraint of, or to monopolize, trade or commerce in a relevant market is unlawful.”⁵

The Court directed lower courts to federal cases applying the antitrust rule of reason:

[F]or evaluating a noncompete agreement between two business entities, . . . MCL 445.784(2) instructs courts to look to federal interpretation of comparable statutes.⁶

The ruling in *Innovation Ventures* is consistent with the Supreme Court’s enforcement of contracts literally—as fundamental to the freedom of contract—regardless of a contract’s reasonableness. In *Rory v Continental Insurance Company*,⁷ the Court held that “mere judicial assessment of ‘reasonableness’ is an invalid basis upon which to refuse to enforce contractual provisions,” because “[w]hen a court abrogates unambiguous contractual provisions based on its own independent assessment of ‘reasonableness,’ the court undermines the parties’ freedom of contract,” which is “the bedrock principle of American contract law”⁸

Rule of reason requires more than unreasonable impact on a party

To invalidate a contract under the antitrust rule of reason requires more than an unreasonable impact on a party. Generally, the rule requires that “the purportedly unlawful contract . . . produced adverse anticompetitive effects within relevant product and geographic markets.”⁹ The antitrust laws were passed for the protection of competition, not competitors. The Supreme Court in *Innovation Ventures* noted that

the proper focus includes whether the noncompete “may suppress or even destroy competition.”¹⁰ Injury merely to the plaintiff or a contracting party or single competitor does not suffice. Instead, “[t]he test under the rule of reason is whether competition in the overall market has been harmed”¹¹

To show that the market has been harmed, a defendant must have market power.¹² This means that a defendant must have a dominant market share with “the ability to raise prices above those that would be charged in a competitive market.”¹³ A plaintiff must show “the market has suffered a reduction in output or an increase in consumer prices.”¹⁴

The codification of the rule of reason in MCL 445.772 contains no special language for noncompetes. The Court did cite some decisions in *Innovation Ventures* identifying certain rule of reason factors, but it would be unwise to assume that those selected citations were an attempt to define a special rule of reason requirement for noncompetes, rather than illustrate that the requirements differ from the reasonableness standard for employee noncompetes.

There are federal cases that apply the rule of reason to commercial noncompete agreements and dismiss claims that fail to prove an adverse impact on competition in the relevant market. For example, in *Lektro-Vend Corporation v Vendco Company*,¹⁵ the court held that a claim to invalidate a commercial noncompete agreement failed “because the plaintiffs did not establish the required § 1 showing of adverse impact upon competition in the relevant market”¹⁶

Drafting enforceable employee noncompetes is a challenge

The typical commercial noncompete agreement does not involve the rule of reason factors—harm to competition in a relevant market, market power, antitrust injury, etc.—and thus is enforceable according to its literal scope, even if unreasonable to a contracting party. By contrast, literal language does not define the enforceability of employee noncompetes, which are used to protect employers’ competitive interests but face legal restrictions to protect the freedom of employees to change employment and maximize the value of their labor.¹⁷ Effective drafters avoid cookie-cutter forms and instead customize to the particular employer, employee, and competitive interest to be protected. Here are five practice pointers.

Have a standalone, signed noncompete agreement

An agreement not to compete buried in an employee handbook risks being unenforceable. Handbooks are not always signed by employees and often contain disclaimers stating that they are not contracts but mere expressions of policy that can be unilaterally changed by the employer. Disclaimers help employers avoid breach of contract claims, but undercut an employer’s ability to enforce a handbook provision as a contract.¹⁸

As a practical matter, lawsuits to enforce noncompetes often are won or lost at the temporary restraining order or preliminary injunction stage. The employer must prove a valid noncompete agreement, and a genuine dispute over whether there was knowing, mutual assent to terms buried in a handbook imperils the grant of injunctive relief.¹⁹ Get a separate signed agreement containing the noncompete provision.

Consider what state's law governs

Noncompetes are creatures of state law, and enforceability varies by state. For example, California²⁰ and North Dakota²¹ prohibit enforcement of certain noncompetes. Illinois requires a certain duration of employment before an employee is deemed to have business information sufficient to warrant a noncompete.²² Other states have similarly unique laws. A choice-of-law provision in the noncompete may help determine which law applies but is no cure-all, as rules for enforceability also vary by state.

Attorneys drafting employee noncompetes should consider not just where the employer is located, but where the employees live and work, which services they perform and where, and which interests are being protected, as well as the noncompete laws of the states that are likely candidates in a dispute over which law applies.²³

Satisfy Michigan's reasonableness requirements

When Michigan law applies, the drafting attorney should include recitals and evidence that help satisfy MCL 445.774a, which provides that an employee noncompete is enforceable if (1) protects the employer's legitimate competitive business interest; and (2) is reasonable as to duration, geography, and type of prohibited employment or line of business. The noncompete should specify the employer's competitive industry, the particular employee's role, the confidential information to

which the employee has access, and other support to argue that a legitimate competitive business interest is protected.

Avoiding competition is not a legitimate business interest, but protecting goodwill (e.g., in the purchase of a business) and confidential information (e.g., regarding customers) may support a noncompete.²⁴ Reasonable geographic, temporal, and occupational restrictions vary. Depending on the business, a reasonable geographic scope can be a few miles, a metropolitan area, a state, a country, or broader.²⁵ Reasonable duration similarly varies; technical information that quickly becomes obsolete does not justify the same duration as protecting a corporation's acquisition targets and strategies in a five-year plan. Restricted employment may be limited to jobs for competitors who can benefit from the employer's proprietary information, or broadly encompass all lines of business in which the employer competes.²⁶

Customize the agreement to the employer and employee

The same noncompete may not work with every employer or even all employees of the same employer. An engineer may have technical information with a short shelf life but with worldwide value to competitors, while a salesperson may be limited to customers in a single city but armed with confidential information that could provide a competitive advantage for years. The employer may have different noncompetes for different employees, with different terms on duration, geography, and scope.

Employers may resist having multiple forms of noncompetes because of cost and inconvenience, but may see the value of a template designed for the employer's business with optional provisions easily customized to the particular employee and interest being protected.

Legal consideration must support the noncompete

Like any contract, a noncompete must be supported by legal consideration. For a new employee, consideration may be the job offer.²⁷ Seeking a new noncompete from an existing employee is more problematic. Continued employment of an at-will employee may be consideration, but not for an employee terminable only for cause.²⁸

The Court in *Innovation Ventures* held that continuation of the business relationship between two companies was sufficient consideration for their commercial noncompete, but "declin[e]d to address in this case whether failure of consideration applies to at-will employees who sign a noncompete agreement after an at-will employment has started."²⁹

Relying solely on continued employment as consideration presents risks. For example, will the employer terminate an existing employee who refuses to sign a new noncompete?



That may be acceptable when employees are easily replaced or poor performers, but termination may be less attractive when the refusing employee is a key engineer, salesperson, executive, etc. Declining to terminate a refusing employee may call into question the adequacy of the consideration for non-competes with those employees who did sign.

One solution is to pay a new benefit with the non-competes, such as a raise, bonus, or promotion.

Conclusion

Employee non-competes agreements should not be based on cookie-cutter forms because they may be enforceable only if carefully drafted to comply with the governing state law which, in Michigan, means reasonably limited to the duration, geography, and scope of work necessary to protect an employer's legitimate competitive interest.

By contrast, commercial non-competes in Michigan are governed by the antitrust rule of reason and may be enforceable even if unreasonable to a contracting party. A typical commercial non-competes will likely not violate the rule of reason requirements of an adverse impact on competition in the relevant market, causing antitrust injury. ■



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ENDNOTES

1. *Innovation Ventures, LLC v Liquid Mfg LLC*, 499 Mich 491, 512; ___ NW2d ___ (2016).
2. *Id.*
3. *Id.* at 496.
4. *Id.* at 511-512.
5. MCL 445.772.
6. *Innovation Ventures*, 499 Mich at 513-514.

7. *Rory v Continental Ins Co*, 473 Mich 457; 703 NW2d 23 (2005).
8. *Id.* at 468-470.
9. *United States v Blue Cross Blue Shield*, 809 F Supp 2d 665, 671 (ED Mich, 2011).
10. *Innovation Ventures*, 499 Mich at 514, quoting *Bd of Trade of Chicago v United States*, 246 US 231, 238; 38 S Ct 242; 62 L Ed 683 (1918).
11. *Hassan v Indep Practice Assocs, PC*, 698 F Supp 679, 695 (ED Mich, 1988); see also *Care Heating & Cooling, Inc v American Standard, Inc*, 427 F3d 1008, 1014-1015 (CA 6, 2005) [explaining that "a complaint alleging only adverse effects suffered by an individual competitor cannot establish an antitrust injury"].
12. *Hand v Central Transp, Inc*, 779 F2d 8, 11 (CA 6, 1985).
13. *NCAA v Bd of Regents*, 468 US 85, 109 n 38; 104 S Ct 2948; 82 L Ed 2d 70 (1984).
14. *Sterling Merch, Inc v Nestlé, SA*, 656 F3d 112, 121 (CA 1, 2011).
15. *Lektro-Vend Corp v Vendo Co*, 660 F2d 255 (CA 7, 1981).
16. *Id.* at 267. *Lektro-Vend* was cited with approval in *Compton v Joseph Lepak, DDS, PC*, 154 Mich App 360, 368; 347 NW2d 311 (1987), and in *Perception, Inc v Sensor Adaptive Machines, Inc*, 221 F3d 913, 918-920 (CA 6, 2000), which was cited with approval in *Innovation Ventures*, 499 Mich 491.
17. US Treasury Department, *Non-competes Contracts: Economic Effects and Policy Implications* (March 2016), p 3 (noting that 18 percent of American workers, or nearly 30 million people, are covered by non-competes agreements).
18. See *Heurtebise v Reliable Bus Computers*, 452 Mich 405; 550 NW2d 243 (1996); *Smith v Chrysler Fin Corp*, 101 F Supp 2d 534 (ED Mich, 2000) (both holding unenforceable an arbitration policy contained in an employee handbook subject to unilateral change by an employer).
19. *Dana Ltd v Am Axle & Mfg Holdings*, unpublished opinion of the US District Court for the Western District of Michigan, issued August 19, 2003 (Docket No. 1:10-cv-450).
20. See Cal Bus & Prof Code § 1660; *Edwards v Arthur Anderson*, 44 Cal 4th 937, 189 P3d 285 (2005).
21. See ND Cent Code § 9-08-06; *Warner & Co v Solberg*, 2001 ND 156; 634 NW2d 65 (2001).
22. *Fivefield v Premier Dealer Svcs, Inc*, 993 NE2d 938 (Ill App, 2013).
23. Malsberger, *Covenants Not To Compete: A State-by-State Survey* (9th ed) (examining in detail each state's law in this area is an indispensable resource to the practitioner drafting and interpreting non-competes agreements).
24. *Id.*; see also *Rooyakker & Sitz PLLC v Plante & Moran PLLC*, 276 Mich App 146, 158; 742 NW2d 409 (2007).
25. Compare *Robert Half Int'l Inc v Van Steenis*, 784 F Supp 1263 (ED Mich, 1991) (finding 50-mile radius from Ann Arbor office in salesperson non-competes to be unreasonable when sales were not performed from that location but were instead conducted from Troy and Southfield), with *Superior Consulting Co v Williams*, 851 F Supp 839 (ED Mich, 1994) (enforcing worldwide non-competes after finding former employer's business was international in scope).
26. The Michigan statute contains an important "savings" clause: to the extent that a covenant not to compete is found to be unreasonable, "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." MCL 445.774a.
27. *Lowry Computer Prods, Inc v Head*, 984 F Supp 1111 (ED Mich, 1997). But see *Kelsey-Hayes Co v Maleki*, 765 F Supp 402 (ED Mich, 1991), vacated and dismissed following settlement, 889 F Supp 1583 (ED Mich, 1991) (finding lack of consideration when consideration for a two-year non-competes was at-will hire).
28. *Id.*; see also *QIS, Inc v Indus Quality Control*, 262 Mich App 592; 686 NW2d 788 (2004) (noting that employees terminable only for just cause under the auspices of a collective bargaining agreement cannot be issued a non-competes as a condition of continued employment and have that continued employment serve as consideration).
29. *Innovation Ventures*, 499 Mich at 511 n 12.