

Track 2: Update on Trade Secret Law in Michigan¹

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I. Michigan's Uniform Trade Secrets Act

A. History

1. The Uniform Trade Secrets Act (UTSA) was recommended for adoption in 1979 and amended in 1985.
2. On December 30, 1998, Michigan became the 43rd state to adopt the UTSA (the "Michigan Act"). 1998 PA 448; MCLA 445.1901 *et seq.*
3. The purpose of the UTSA is to make trade secrets law uniform among the states enacting it and to codify the results of the better reasoned trade secrets cases. MCLA 445.1909; UTSA, Commissioners Prefatory Note, 14 ULA 310.

B. Elements of a Trade Secrets Claim Under the Michigan Act

1. Plaintiff must first establish the existence of a trade secret.
 - (a) The Michigan Act [MCLA 445.1902(d)] defines trade secret as "information, including a formula, pattern, compilation, program, device, method, technique, or process, that is both of the following":
 - (1) "Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use."
 - (2) "Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."
 - (b) The Michigan Act's definition of trade secrets is different from the definition which had previously been adopted by the Michigan Supreme Court in *Hayes-Albion-Corp v Kuberski*, 421 Mich 170 (1984).
 - (1) The *Hayes-Albion* Court, quoting Restatement of Torts, §757, comment b, defined a trade secret as follows:
 - i. "A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and

1. See generally, Pappas, McNeill & Quick, *Michigan Business Torts* (2nd ed. 2003).

which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers.” *Hayes-Albion Corp, supra*, at 181.

- ii. Information that is in the realm of general skills, knowledge, and experience is not a protectable trade secret. *Hayes-Albion Corp, supra*.
 - iii. The *Hayes-Albion Corp* Court looked to the Restatement (Second) of Torts, Section 757, for six factors to determine whether trade secrets exist, although these factors are not exclusive:
 - the extent to which the information is known outside of the business; if readily obtainable, it is not a trade secret.
 - the extent to which it is known by employees and others involved in the business; if it is not treated like a secret, it isn’t.
 - the extent of measures taken by the employer to guard the secrecy of the information; this factor applies both internally and externally – have the secrets been disclosed to customers without a confidentiality agreement in place?
 - the value of the information to the employer and its competitors; this factor assesses the degree to which information can be found in the marketplace.
 - the amount of effort or money expended by the employer in developing the information; and
 - the ease or difficulty with which the information could be properly acquired or duplicated by others.
- (c) Although the Restatement factors appear to be more restrictive than the UTSA definition of trade secrets, the Restatement factors are still useful as guidelines in determining whether information is a trade secret. See, e.g., *Minutemen, Inc v Alexander*, 147 Wis 2d 842, 434 NW2d 773, 778 (1989); 12 R. Milgrim on Trade Secrets, §2.01[1] (1987). See, also, *Merrill Lynch, Pierce, Fenner & Smith, Inc v Ran*, 67 Supp 2d 764, 775 (ED Mich. 1999), citing *Hayes-Albion Corp, supra*, and Michigan common law in support of holding that customer lists are entitled to trade secret protection under the Michigan Act. Courts applying the Michigan Act continue to look at pre-Michigan Act cases to help define the parameters of trade secret law. See, e.g., *McKesson Medical – Surgical, Inc. v Micro Bio-Medics, Inc*, 266 F Supp 2d 590 (ED Mich 2003).
- (d) The Michigan Act’s definition is broad enough to cover customer lists and customer information if they qualify as a trade secret. See, e.g., *Electronic Planroom, Inc v McGraw-Hill Companies, Inc.*, 135 F Supp 2d 805 (ED Mich 2001); *Merrill Lynch, supra*; the *Minutemen* case, *supra*; cf. *Kubik, Inc*

v *Hull*, 56 Mich App 335 (1974) and *McKesson*, *supra*, holding that customer information cannot rise to the level of a trade secret.

2. Plaintiff must also establish actual or threatened misappropriation of the trade secrets of another.
 - (a) Under the Michigan Act [MCLA 445.1902(b)], misappropriation “means either of the following”:
 - (1) “Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means.”
 - (2) “Disclosure or use of a trade secret of another without express or implied consent by a person who did one or more of the following:
“Used improper means to acquire knowledge of the trade secret.”
“At the time of disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was derived from or through a person who had utilized improper means to acquire it, acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use, or derived from or through a person who owed a duty to the person to maintain its secrecy or limit its use.”
“Before a material change of his or her position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.”
 - (b) Improper means under the Michigan Act “includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy or espionage through electronic or any other means.” MCLA 445.1902(a).

C. Remedies Under the Michigan Act

1. Actual or threatened misappropriation may be enjoined. MCLA §445.1903(1).
 - (a) The Michigan Act does not specify the factors which should be considered in deciding whether to grant injunctive relief, leaving the Michigan courts to rely on the procedures and common law principles applicable to injunctive relief generally.
 - (b) The use of the term “threatened” opens the door for the Michigan courts to apply the inevitable disclosure doctrine, which can be used to obtain injunctive relief in limited circumstances where a plaintiff can show that it is inevitable that a former employee working for a competitor will disclose plaintiff’s trade secrets. See, e.g., *PepsiCo, Inc v Redmond*, 54 F3rd 1262 (CA7, 1995). However, “for a party to make a claim of threatened misappropriation, ... the party must establish more than the existence of generalized trade secrets and a competitor’s employment of the party’s former employee who has knowledge of trade secrets.” *CMI International, Inc. v. Internet Int’l. Corp.*, 251 Mich. App. 125, 134 (2002).
 - (c) An injunction will be terminated when the trade secret ceases to exist, but the injunction “may be continued for an additional reasonable period of time

in order to eliminate commercial advantage that otherwise would be derived from the misappropriation”. MCLA 445.1903(1).

- (1) The Commissioners Comment to the UTSA, §2, 14 ULA 544-45 (1985), provides that “subject to any additional period of restraint necessary to negate lead time, an injunction accordingly should terminate when a former trade secret becomes either generally know to good faith competitors or generally knowable to them because of the lawful availability of products that can be reverse engineered to reveal a trade secret”.
 - (2) The Court in the *Minutemen* case, *supra*, at 443 NW 2d 773, 778-79, stated that the “Commissioners’ comments to the UTSA note that discovery by reverse engineering is a proper means to discover a trade secret”, but held that the “possibility of reverse engineering a trade secret, however, is not a factor in determining whether an item is a trade secret, but rather it is a factor in deciding how long the injunctive relief should last”.
- (d) ”If a court determines that it would be unreasonable to prohibit future use of a trade secret, an injunction may condition future use upon payment of a reasonable royalty for no longer than the period of time the use could have been prohibited.” MCLA 445.1903(2).
- (1) The Michigan Act adopts the original version of the UTSA, not the 1985 amendments to the UTSA.
 - (2) In an attempt to limit a court’s discretion, the 1985 amendments to the UTSA provide that a royalty injunction should only be available in “exceptional circumstances”, but the 1985 amendments clarify what was suggested in the comments to the original UTSA – i.e., that exceptional circumstances “include, but are not limited to, a material and prejudicial change of position prior to acquiring knowledge or reason to know of misappropriation that renders a prohibitive injunction inequitable”. Uniform Laws Annotated, Trade Secrets, §2(b).
- (e) A court may also compel other “affirmative acts” to protect a trade secret, such as “the return of stolen blueprints or the surrender of surreptitious photographs or recordings”. MCLA 445.1903(3); UTSA Commissioners Comment, §2, 14 ULA 316.

2. Compensatory Damages

- (a) “Except to the extent that a material and prejudicial change of position prior to acquiring knowledge or reason to know of misappropriation renders a monetary recovery inequitable, a complainant is entitled to recover damages for misappropriation”. MCLA 445.1904.
- (b) Under the Michigan Act (MCLA 445.1904) damages can include:
 - (1) “[A]ctual loss caused by misappropriation”; and
 - (2) “[U]njust enrichment caused by misappropriation that is not taken into account in computing actual loss.”

- (c) “In lieu of damages measured by any other methods, the damages caused by misappropriation may be measured by imposition of liability for a reasonable royalty for a misappropriator’s unauthorized disclosure or use of a trade secret.” MCLA 445.1904.
- 3. The Michigan Act (MCLA 445.1905) gives discretion to the court to award reasonable attorney’s fees to the prevailing party if:
 - (a) “a claim of misappropriation is made in bad faith”;
 - (b) “a motion to terminate an injunction is made or resisted in bad faith”;
 - (c) “willful and malicious misappropriation exists”.
- 4. The Michigan Act did not adopt the UTSA provision allowing the recovery of punitive or exemplary damages.

D. Miscellaneous Provisions of the Michigan Act

- 1. “In an action under this act, a court shall preserve the secrecy of an alleged trade secret by reasonable means, which may include granting protective orders in connection with discovery proceedings, holding in camera hearings, sealing the records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval”. MCLA 445.1906.
 - (a) In order to prove the existence of a trade secret, a plaintiff will be required to identify the specific information which constitutes a trade secret.
 - (b) MCLA 445.1906 requires the court to take steps to preserve the secrecy of the information identified as a trade secret.
- 2. “An action for misappropriation must be brought within 3 years after the misappropriation is discovered or by the exercise of reasonable diligence should have been discovered. For the purposes of this section, a continuing misappropriation constitutes a single claim.” MCLA 445.1907.
 - (a) The three-year statute of limitation in the Michigan Act is consistent with prior Michigan law. See MCLA 600.5805(8).
 - (b) The Michigan Act clarifies, however, that the limitation period begins to run when the misappropriation “is discovered or by the exercise of reasonable diligence should have been discovered” and that a new limitation period does not begin to run by a continuing misappropriation occurring at a later date.
- 3. The Michigan Act “displaces conflicting tort, restitutionary, and other law of this state providing civil remedies for misappropriation of a trade secret”, but it does not affect “contractual (or criminal) remedies whether or not based on misappropriation of a trade secret” or other “civil remedies that are not based upon misappropriation of a trade secret”. MCLA 455.1908.
 - (a) The Michigan Act does not affect confidentiality agreements or covenants not to compete, which are governed by other law. See UTSA Commissioners Comment, §7, 14 ULA 323 (1987).

- (b) Under Michigan Common law, confidential information that does not qualify as a trade secret may still be protected by a confidentiality agreement. *Folmer, Rudzeqica & Co v Kosco*, 420 Mich 394, 402-403 (1984), or as a result of an employee's continuing fiduciary duty not to use confidential information acquired during the employment relationship. *Chem-Trend, Inc. v McCarthy*, 780 F. Supp. 458, 463 (ED Mich, 1991); *Folmer, supra*, at 403, 404.
 - (c) To be protectible information, even though it is not a trade secret, the information must still be "confidential" and give an unfair advantage to the former employee who discloses or uses it. *Folmer, supra*, at 407.
4. The Michigan Act "takes effect October 1, 1998 and does not apply to misappropriation occurring before the effective date. With respect to a continuing misappropriation that began before the effective date, this act does not apply to the continuing misappropriation that occurs after the effective date". MCLA 445.1910

II. Covenants Not to Compete

A. History of Michigan Law

1. For 80 years, Michigan law prohibited most noncompetition agreements as "against public policy, illegal and void."
MCL 445.762, MSA 28.61
2. Effective March 29, 1985, "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 of employment if the agreement or covenant is reasonable as to its duration, geographic area, and the type of employment or line of business."
MCL 445.774a

The statute expressly give the Court the ability to "blue pencil" the contract, - *i.e.*, if the Court believes that any term of the contract is unreasonable in violation of the statute, the Court may rewrite the offending term and limit it to something reasonable. This is totally discretionary, and the statute counsels that blue penciling should be done only "in light of the circumstances in which it was made." Commentators have noted that this doctrine is subject to abuse by employers who purposely write over-broad terms based on the assumption that, if found over-broad by the Court, the Court will still enforce some sort of non-compete provision.

B. Whether a Covenant Is Valid Under Michigan Law

1. The agreement must protect reasonable competitive business interests. Trade secrets are unquestionably such an interest, and thus many non-compete cases often devolve into trade secret cases. Outside of that well-worn territory, the law

is relatively open to arguments as to what could constitute a “reasonable competitive business interest.” See, e.g., *CMI, supra*; *Ran, supra*.

2. The agreement must be reasonable as to its duration, geographic area and type of employment or line of business. What is reasonable depends on the industry and facts of the case; national case law is irreconcilable and a case can be found for or against almost any issue.
 - (a) Duration: There is no simple rule as to what is a reasonable time duration. The time period imposed should relate to the interest being protected - for example, the time needed to train a new employee or to develop an equivalent relationship with the old employee’s customers. The particular industry may be relevant (e.g., a longer duration in fast moving industry like computers may make less sense than in other situations).
 - (b) Geographical area: The test here should be whether competition by the ex-employee at a specific location or even nationally or worldwide would adversely impact the business of the ex-employer. See, e.g., *Owens v Hatler*, 373 Mich 289 (1964); *Lowry Computer Products, Inc., v. Head*, 984 F. Supp. 1111, 1116 (E.D. Mich. 1997); *Superior Consulting Co v Walling*, 851 F.Supp. 428 (E.D. Mich. 1993).
 - (c) Type of Employment or Line of Business: The type of employment or the line of business being protected should correspond with the type of business of the employer seeking the benefit of the covenant and the employment duties of the employee in question. A complete bar on working in any capacity for a competitor may be overbroad.

C. Alternative Non-Competes: “Pay To Play” Contracts

Pay to Play: Prior to the revision of Michigan law such that non-compete agreements were enforceable, the Supreme Court authorized “pay to play” contracts, which provided that if a former employee engaged in a competing business, he or she would have to pay some set amount of money to the former employer. *Folmer, supra*. The court must still consider whether the agreement is reasonable and reasonably related to a legitimate business interest such that the contract is not an improper restraint of trade or commerce.

D. Preliminary Injunctive Relief for Noncompetition Agreements

1. Preliminary injunctive relief is available to enforce a valid noncompetition agreement as long as the usual criteria for injunctive relief are present: likelihood of success on the merits, irreparable injury which outweighs the harm to the defendant, and public interest.
2. Likelihood of Success on the Merits
 - (a) Must first determine whether there is a valid noncompetition agreement supported by consideration.
 - (b) Then must determine whether the agreement protects reasonable competitive business interests.

- (c) Then must determine whether agreement is reasonable as to duration, geographical area and type of employment or line of business.
3. Irreparable Injury
 - (a) Competitive losses, such as the loss of customers' goodwill and the loss of fair competition, can constitute irreparable injury if they are difficult to quantify. See, e.g., *Basicomputer Corp v Scott*, 973 F2d 507, 511-512 (6th Cir 1992); *Superior Consulting Co, supra*; and *Chem-Trend, supra*.
 - (b) Preliminary injunctive relief is an extraordinary remedy and should not be granted where there is an adequate remedy at law.
 4. Balance of Harms and Public Interest

The Court must balance the employer's legitimate business interest, the public interest and the employee's interest in being able to earn a living using his or her talents and expertise.
 5. Application of Other Equitable Doctrines
 - (a) Laches, undue delay
 - (b) Bad faith
 - (c) Unclean hands
 6. Requiring a Bond

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