Four Considerations When Drafting a Noncompete Agreement That Can Affect Its Enforceability

By John A. Hubbard and Eric A. Parzianello

A frequent question from business clients is whether a noncompete agreement is enforceable after an employee has been terminated. Although the former employee may assert a number of potential defenses to the noncompete, the employer can anticipate many of these by carefully drafting the agreement. That, in turn, will enhance the likelihood that the court will enjoin the employee from competing against a former employer when the employee has violated a covenant not to compete. Cases from other jurisdictions often provide instructive considerations regarding potential drafting issues. Below are four issues taken from such recent cases that, if satisfactorily addressed, can help in enforcing a noncompete.

Does the noncompete contain an independent covenant provision?

A typical defense of an employee sued for violating a noncompetition agreement is that the employer breached some agreement, either by failing to pay amounts due under the contract or committing some other breach. Although this could otherwise constitute a valid defense to the employer's motion for an injunction, that may not be the case if the noncompete is an independent covenant.

In the recent Florida case of *Richland Towers, Incorporated v Denton*,[1] the trial court found that the employer had not paid bonuses to the employee as required under the employment agreement. The court held that this was a prior breach rendering the noncompetition covenants unenforceable. The Second District Court of Appeals reversed. It found that to "reach this conclusion, the circuit court necessarily had to determine that the parties' obligations under the contracts were dependent covenants. When a dependent covenant has been breached, the entire contract is virtually destroyed."[2]

But in *Richland Towers*, the agreement explicitly stated that the noncompete was independent of the other covenants:

> Covenants Independent. Each restrictive covenant on the part of the Employee set forth in this Agreement shall be construed as a covenant independent of any other covenant or provisions of this Agreement or any other agreement which the Corporation and the Employee may have, fully performed and not executory, and the existence of any claim or cause of action by the Employee against the Corporation, whether predicated upon another covenant or provision of the Agreement or otherwise, shall not constitute a defense to the enforcement by the Corporation of any other covenant.[3]

Nevertheless, the employee argued that this language should be construed "to make the restrictive covenants independent only of other conditions that had been 'fully performed and not executory.'" The Florida Second District disagreed. Instead, it found that the employee's interpretation would effectively ignore the plain language of the agreement. Therefore, because the covenants

were explicitly independent, the Second District held that the employer's prior breach of the agreement was not a defense to enforcing the noncompetition provision.

Practice Tip: Either an independent covenant provision (such as the one above) or simply a standalone agreement can aid an employer in seeking an injunction over an employee's claim of prior breach.

Has adequate consideration been identified?

Whether the employee received consideration for the noncompete agreement can be an issue of fact. To help avoid this, the employer should specifically recite the consideration. In a fully integrated agreement, this can prevent a factual dispute on the issue of consideration.

In the recent Michigan case of *Posselius v Springer Publishing Company, Incorporated*,[4] an employee challenged a contractual limitations period in an employment handbook's acknowledgment form. The provision read:

> I agree that in consideration for my employment or continued employment that any claim or lawsuit arising out of my employment with, or my application for employment with, the Company or any of its principals or subsidiaries must be filed no more than six (6) months after the day of the employment action that is the subject of the claim or lawsuit. While I understand that the statute of limitations for claims arising out of an employment action may be longer than six (6) months, I agree to be bound by the six (6) month period of limitations set forth herein, and I WAIVE ANY STATUTE OF LIMITATIONS TO THE CONTRARY.[5]

Claiming that the six-month limitation period was unenforceable, the employee argued that the employer was "attempting to enforce the provisions contained in the employment application as if it is a contract, a contract where the Defendants have *absolutely no obligation*."[6] The Michigan Court of Appeals disagreed. It reiterated its prior holding in *QIS, Incorporated v Industrial Quality Control, Incorporated*,[7] that "[m]ere continuation of employment is sufficient consideration to support a noncompete agreement in an at-will employment setting."[8] Accordingly, the court in *Posselius* held that the employee's mere continuation of employment was sufficient consideration for the limitations period in the acknowledgment form.

Elsewhere, a Texas court recently upheld the sufficiency of consideration in a noncompetition agreement. In *Dickerson v Acadian Cypress & Hardwoods, Incorporated*,[9] an employee claimed that his agreement not to compete was unenforceable because he received no consideration. In addition to preventing the employee from competing against the employer in the wood-products business, the covenant stated:

> Employee recognizes and acknowledges that he/she will have access to certain confidential information of the Company, its

FAST FACTS

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Recite the consideration provided for a noncompete to help avoid doubt regarding whether sufficient consideration exists.

Include a provision that permits the noncompete to be assigned and provides for affiliates to be third-party beneficiaries.

customers, and entities affiliated with the Company, and that such information constitutes valuable, special and unique property of the Company and such other entities.[10]

In *Dickerson*, the evidence showed that the employee was indeed provided with customer lists containing contact information, sales histories, sales reports, and pricing information relevant to the employer's business. The Texas Court of Appeals found that the employer provided consideration for the noncompete agreement by supplying the employee "with confidential information about its customers after the effective date of the agreement."[11]

Practice Tip: Specifically recite the consideration in a noncompete. This will help avoid doubt whether there is sufficient consideration.

Does the noncompete permit assignment?

Noncompete agreements should expressly permit the employer to assign the agreement or identify related companies that may enforce the covenant. This is especially important if the employer later reorganizes or is acquired by another entity. For example, in *Richland Towers, supra*, the employer that signed the original agreement ceased active operation in late 2008 and was acquired by an affiliate. Nevertheless, the agreement stated that the employer's affiliates could enforce the noncompetition agreement:

> Corporation (and each of the Affiliates comprising the Corporation) shall be deemed to be third party beneficiaries under this Agreement with the right to seek enforcement hereof and make claims hereunder, including but not limited to claims arising under this Section 10.

The Florida Court of Appeals therefore enforced the noncompete agreement, even though the former employer was acquired by another entity. But without the provision allowing third-party beneficiaries, the employee's defense to enforcement may well have been valid.

Practice Tip: State that the noncompete may be assigned and that affiliates are third-party beneficiaries.

Are the terms of the noncompete reasonable?

Noncompetition agreements in Michigan are only enforceable to the extent they are reasonable. MCLA 445.774a codifies the reasonableness factor:

> 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, 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.

If the noncompete overreaches, the court may refuse to enforce it entirely. In *Teachout Security Services, Incorporated v Thomas*,[12] the plaintiff hired security officers as employees. The employees signed a noncompete agreement "restricting them for 12 months from working for a competing security firm at the same site they had worked…."[13] The noncompete agreement further stated:

> Employee acknowledges that the covenants and agreements which Employee has made in this Agreement are reasonable and required for the reasonable protection of [Employer] and its respective relationships to customers, employees and agents.[14]

The employees thereafter attended a training and orientation session that lasted no more than 8 hours and then participated in an additional 16 hours of instruction. Subsequently, a competing security firm hired them away from the plaintiff. The competing firm underbid the plaintiff for the contract of providing security at the site where the employees were trained.

The plaintiff sued to prohibit its former employees from working for the competitor. The Michigan Court of Appeals, however, concluded that where the knowledge acquired by defendants in providing security "is merely general knowledge accumulated in their day to day positions,"[15] *any* enforcement of the noncompete provision would be unreasonable. Thus, although a Michigan court may indeed modify a noncompete covenant under MCLA 445.774a, the court may reject the noncompete altogether if it is wholly unreasonable.

A similar result was recently reached in an Arkansas federal court. In *Morgan v West Memphis Steel & Pipe, Incorporated*,[16] the employees were prohibited from soliciting the business of the employers' "past, present, or prospective future customers or clients" within a 175-mile radius of West Memphis, Arkansas.[17] The court held that because the noncompete clause attempted to restrict the employees more than was reasonably necessary to protect the employer's legitimate interest, it was overbroad. Because

under Arkansas law the court could not blue-pencil the clause, it voided the covenant in its entirety like the Michigan court in *Teachout, supra*.

Practice Tip: Do not overreach. Tailor the noncompete to be reasonable given the specific parties and activity in question.

Conclusion

The law regarding noncompete agreements continues to evolve. Careful drafting, however, can avoid many potential defenses to the enforcement of the covenants. ∎

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ENDNOTES

1. *Richland Towers, Inc v Denton*, 139 So 3d 318 (Fla Dist Ct App 2014).
2. *Id.*
3. *Id.*
4. *Posselius v Springer Pub Co, Inc*, unpublished opinion per curium of the Court of Appeals, issued April 17, 2014 (Docket No. 306318).
5. *Id.* at *1.
6. *Id.* at *6.
7. *QIS, Inc v Indus Quality Control, Inc*, 262 Mich App 592, 594; 686 NW2d 788 (2004).
8. *Id.*
9. *Dickerson v Acadian Cypress & Hardwoods, Inc*, unpublished opinion of the Texas Court of Appeals, issued April 10, 2014 (Docket No. 09-13-00299-CV).
10. *Id.* at *5.
11. *Id.*
12. *Teachout Sec Services, Inc v Thomas*, unpublished opinion of the Court of Appeals, issued October 19, 2010 (Docket No. 293009).
13. *Id.* at *5.
14. *Id.* at *5.
15. *Id.* at *4.
16. *Morgan v West Memphis Steel & Pipe, Inc*, ___ F Supp 2d ___ (ED Ark, 2014).
17. *Id.* at *1.