COVENANTS NOT TO COMPETE IN MICHIGAN

General Law

For a period of approximately 80 years, covenants not to compete against employees were not enforceable in Michigan. The antitrust "rule of reason" allowed employers and other parties to protect their confidential information, but that permitted activity was often confused with restrictive covenants.

In 1985, Michigan enacted the Michigan Antitrust Reform Act (MARA), reinstating prior law enabling restrictive covenants to be imposed upon employees and other contracting parties. Since MARA was passed, a variety of contested Michigan cases arising in various industries and fields have offered guidance as to when and how a particular restrictive covenant may be declared "reasonable" under the circumstances.

Our firm has taken part in many litigated disputes involving covenants not to compete, and is frequently instructed to draft or assess clauses attempting to restrict whether and to what extent an employee or seller of a business or profession may compete with the other party. This article and companion articles noted below explore many of the legal principles we have brought to bear in those endeavors.

The Four Primary Legal Elements

The starting place for understanding the enforceability of a covenant not to compete on an employee is found in the four decisive elements Michigan courts typically cite when reaching their decisions on contested covenants not to compete: (1) the covenant's duration; (2) the geographical scope; (3) the restricted activities; and (4) whether the employer presents legitimate "competitive business interests" in need of protection. These factors are all mentioned in the governing statute found in MARA.

Any one factor can be decisive and can cause a covenant to be declared illegal, particularly if the employer attempts to overreach with the desired restriction. For the most part, however, the factors tend to work together in a decision, particularly when the court is inclined to declare the covenant legal and enforceable.

Covenant Duration. Michigan courts exploring the duration feature of a covenant not to compete frequently recite this particular general standard: **"**Michigan courts have routinely upheld non-compete agreements restricting the former employee from engaging in restricted activities for periods of six months to three years." See, e.g., *Kelly Services, Inc. v. Marzullo,* 591 F. Supp. 2d 924, 939 (ED MI 2008).

Technically, it is true that at least three reported Michigan appellate cases have enforced a restrictive employment covenant with a term of three or more years. These rulings and the cases themselves, however, are anything but typical and do not accurately reflect the common practice in Michigan. A restrictive covenant of six months to two years is more typical in Michigan. This

duration is defensible, as long as the other elements of the clause and employee circumstances recited herein can be presented by the employer.

For a more complete exploration of this particular element of covenants not to compete, see our companion article, I*S MY COVENANT NOT TO COMPETE TOO LONG? The Legal Standard in Michigan.*

Geographical Scope. The geographical element of a covenant not to compete has proven to be much more variable than the duration element. Indeed, it is possible to enforce a covenant which presents no geographical radius at all, particularly when the covenant effectively replaces the geographic limits with a non-solicitation restriction as to the employer's clients or customers. If that soliciting activity is carefully defined and set forth in the clause, and it fairly mirrors the employee's prior duties for the employer, the courts will enforce such a clause.

Technically, such provisions are frequently referred to as "non-solicitation" clauses, but they fall into the same framework of legal analysis for purposes of determining their legal viability.

On the other end of the spectrum, there are geographical limits that run as low as five to seven miles. These clauses are particularly prevalent in the health care field, due to the geographical sensitivity of those firm's operations. When dealing with a sales person or other employee servicing a defined territory, clauses which limit the employee's covenant to that territory are usually enforceable, as long as the restricted activities are tied to the employee's former operations, and the covenant is of reasonable duration.

For a more complete exploration of this particular element of covenants not to compete, see our companion article, *WHAT ARE THE BOUNDARIES OF MY KINGDOM? Geographical Limits in Michigan, Covenants Not to Compete.*

Restricted Activities. The restrictive covenant has no meaning without a statement describing the activities which are forbidden. This element of a restrictive covenant presents a peculiar drafting challenge which cannot always be resolved with a simple numerical value or reference to customers and clients. Courts do not favor covenants which appear designed to simply prohibit competition.

In some circumstances, the covenant can merely state that the restricted party may not compete with the other party. This tactic, however, can easily run afoul of the rule against unduly restricting competition. For example, prohibiting participation in "any enterprise in competition with the Company" was rejected because the employer offered a multitude of services and products; it was unreasonable to prohibit the employee from working for any firm which happened to occupy a spot in any of those markets. *Coates v. Bastian Bros., Inc.*, 276 Mich. App. 498, 507 (2007).

With some exceptions, both parties' interests are better served by a clause which spells out the activity which the employee is purportedly barred from undertaking. Such clarity in drafting enables the parties to frequently avoid unwanted litigation. For a more complete exploration of

this particular element of covenants not to compete, see our companion article, *COVENANTS NOT TO COMPETE IN MICHIGAN: Permitted Scope of Restricted Activities.*

Competitive Business Interests. Michigan courts require an employer to present proof that its "competitive business interests" are unfairly in jeopardy in the absence of the covenant not to compete. To be judged reasonable, a restrictive covenant must protect against the employee gaining some unfair advantage in competition with the employer, but not prohibit the employee from using general knowledge or skill.

In most cases, this term means trade secrets, confidential information about the company's products or customers, or confidential information about the business itself. The presence of such information, and the apparent theft of such information, lead the court to enforce a lengthy three year covenant in *Actuator Specialties.* On the other end of the spectrum, the Court would not enforce a covenant of relatively modest length (one year) against security guards who possessed no confidential information and had received only limited training from the employer. *Teachout Security Services v. Thomas*, 2010 Mich. App. LEXIS 2011.

For a more complete exploration of this particular element of covenants not to compete, see our companion article, *COMPETITIVE INTERESTS WHICH MAY BE PROTECTED IN RESTRICTIVE COVENANTS.*

Non-Statutory Elements

Parties negotiating or litigating restrictive covenants naturally gravitate to factors other than those set out in MARA. The following elements have been discussed or have arisen in one or more Michigan case since MARA was enacted in 1985.

Fired or Quit. Most covenants not to compete are drafted to apply whether the employee quits or was fired. There is some but surprisingly little authority or discussion in Michigan case law on the impact of the "firing vs. quitting" distinction on a covenant not to compete. This absence of attention to this factor, which is frequently raised by the litigants, may be owing to the fact that the governing statute (MARA) offers no express distinction as to who initiates the termination.

At least one court considered this argument, but rejected the contention when the contractual clause made clear that it applied regardless of how the employment was terminated. Unlike some other states, the Michigan appeals courts have not declared that a firing voids the covenant not to compete.

Length of Employment. An employee's length of service often receives meaningful attention from the courts, but usually in conjunction with other factors. For example, a court might cite an employee's lengthy tenure with the employer and the familiarity with customers and products that comes along with it as a reason to keep him from "stealing" customers. Length of employment is usually not treated as the only or even a primary factor in deciding the enforceability of a covenant not to compete.

Unclean Hands. The general rule is that a party who comes to court with "unclean hands" (meaning the party has behaved badly) is not entitled to relief. A similar principle appears to be in play when restrictive covenants are contested, particularly when an employer seeks to enjoin an employee at the outset of the case. The employee's perceived bad behavior in one case (uploading confidential computer files, violating the temporary restraining order, and using deceptive forms) appears to have been a major factor in causing one court to enforce a rather unusually lengthy restrictive covenant of three years.

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