COMPETITIVE INTERESTS WHICH MAY BE PROTECTED IN RESTRICTIVE COVENANTS

Introduction

After identifying the three elements which are drafted into a covenant not to compete: duration, geographical scope and the restricted activities – Michigan courts recite the "fourth" important element which need not be expressly set forth in the covenant itself: the competitive interests which may be protected.

Despite the lack of a legal requirement, drafters of restrictive covenants nonetheless frequently include a preamble of sorts where the restricted party (usually the employee or seller of a business) acknowledges that important interests which must be protected are at stake. These interests are usually described in broad terms such as "client identity," "confidential information," or "trade secrets."

Regardless of whether the issue arises in contract negotiations or a lawsuit, the contracting parties and their counsel must fully understand the legally protectable competitive interests which may be protected, and be aware of the less compelling interests courts will not protect when presented with a restrictive covenant.

What Competitive Interests May Be Protected?

To be judged reasonable and enforceable, a restrictive covenant must protect against the employee gaining an unfair advantage in competition with the employer. These enforceable interests usually fall into several readily identifiable categories:

1. Customer information and data
2. Confidential information or trade secrets
3. Technical product information
4. Contract terms and renewal dates, and pricing

The term "seller" can be substituted for "employer" when referring to business purchase and sale transactions containing a restrictive covenant.

As with the textual elements of a covenant not to compete, this inquiry tends to be inherently fact specific. *Capaldi v. Liftaid Transport, L.L.C.,* 2006 Mich. App. LEXIS 3199. Michigan courts have, however, consistently enforced reasonable covenants when the employer can demonstrate that the employee possesses its confidential business information. *See, e.g., Lowry Computer Prods., Inc. v. Head,* 984 F. Supp. 1111, 1116 (E.D.Mich.1997) (sales agent of computer hardware and software firm).

Similar judicial respect has been evident when client or customer relationships are at stake. In one rather extreme example, the Court of Appeals upheld a lengthy five year covenant against a former employee which prohibited her from any contact with the employer's patients. *Neocare Health Sys. v. Teodoro,* 2006 Mich. App. LEXIS 240, at 6-7. The Court was apparently influenced

by the employee's close relationship with the patients, and the fact that she was permitted to compete in the same location, as long as she did not perform services for the former employer's patients.

What Interests Will Not Be Protected?

The general rule in Michigan concerning competitive interests which will not be protected is usually stated as follows:

> [G]eneral knowledge, skill, or facility acquired through training or experience . . . acquired or developed during the employment does not, by itself, give the employer a sufficient interest to support a restraining covenant . . . ." *Follmer, Rudzewicz & Co v Kosco,* 420 Mich. 394, 402 (1984).

In a recent case, the employer attempted to enforce a one-year covenant not to compete against security guard employees. *Teachout Security Services v. Thomas,* 2010 Mich. App. LEXIS 2011, at 8-9. Even this modest restriction was unenforceable where the employees had received limited formal training (eight hours) and had gained only general knowledge through their employment.

In yet another case, the employer's contention that its former employees knew about the "habits, preferences and personal matters" pertaining to bankers, lawyers, realtors and referral sources of the former employer was rejected by the Court as competitive interests which would make a covenant enforceable. *N. Mich. Title Co. v. Bartlett*, 2005 Mich. App. LEXIS 733. In the view of the Court, such information was readily accessible by joining a club or other means.

The competitive interests to be protected must thus be tightly drawn. There is some peril in the preamble "purpose" clauses frequently found in restrictive covenants. If these clauses state their purpose too broadly, they can be used against the drafter to strike down the clause.

Conclusion

Even though a restrictive covenant need not recite its purposes, it is clear that under Michigan law valid competitive interests are necessary to the enforceability of such restrictive covenants. As noted above, both parties must carefully attend to this important legal feature of restrictive covenants.

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