COVENANTS NOT TO COMPETE IN MICHIGAN:
PERMITTED SCOPE OF RESTRICTED ACTIVITIES

General Law

The heart of any restrictive covenant derives from the statement of activities which are restricted. While this is only one of the four elements Michigan courts analyze when deciding the enforceability of a covenant not to compete, it is essential to the very existence of these covenants.

The general rules for the restrictive description are fairly easy to identify and recite. The covenant must be carefully designed to protect against the employee gaining some unfair advantage in competition with the employer. The covenant must not be drafted for the sole purpose of preventing competition, or – in an employment setting - prohibiting the employee from using general knowledge or skill learned on the job with the employer. *See, e.g., Follmer, Rudzewicz & Co, PC v Kosco,* 420 Mich. 394, 402-404 (1984).

What Activities May Be Restricted?

Most Michigan cases discussing this element of a covenant not to compete involve employment relationships. We will thus discuss these restrictions in that setting even though these principles are transferable to other contractual relationships.

The restrictive language in a covenant not to compete is most effective when it reflects a party's legally protectable interests. If the employee had access to truly confidential information the employer is entitled to protect, then the protective covenant may directly prohibit the employee's use of that particular information.

The outcome in reported Michigan cases is mixed regarding restrictive covenants which state an employee cannot "compete" with the employer. Ordinarily, such an ill-defined proscription will work only when one or more of the other elements of the restrictive covenant compensates for that deficiency. For example, a restrictive covenant barring a former employee from all medical practice was upheld, but largely because that restriction applied only in a tightly drawn seven mile radius. *St. Clair Med., P.C. v. Borgiel,* 270 Mich App 260 (2006). The minimal radius effectively compensated for the imprecise restriction in the covenant.

The drafting technique of prohibiting "any competition" was rejected in a different case because the employer offered a multitude of services and products; it was unreasonable to prohibit the employee from working for any firm which had a presence in any of those markets. *Coates v. Bastian Bros., Inc.,* 276 Mich. App. 498, 507 (2007). That clause was thus struck down.

An employer may avoid this controversy by prohibiting all contact or commerce with the employer's customers and prospects. Courts are far more likely to recognize and respect an employer's right to protect existing customers and contacts, particularly when the employee was introduced to those customers or clients through the employer. This was the restrictive means employed in the *Follmer Rudzewicz, supra* case cited above, and is a favorite tactic of accounting firms.

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This methodology, however, also has its limits. For example, in one case the former employer overstepped when it prohibited the former employee from providing “any services” for its clients, rather than just limiting the prohibition to the nursing services the employee previously provided. *A Complete Home Care Agency, Inc. v. Gutierrez,* 2004 Mich. App. LEXIS 1839,

Industry and Profession Characteristics

The examples set forth above demonstrate that the peculiar characteristics of an industry or profession can have a profound impact on the type of restrictive covenant which will pass legal muster with the Michigan courts. Accounting firms are privy to sensitive financial information and confidential data concerning their clients. Former employees (or stockholders) would not have learned that information without the employment relationship. Covenants which restrict access to clients thus make some sense in this setting as long as the other elements are not drawn too broadly. The customers serviced by a title insurance company, on the other hand, are not as likely to be repeat customers over a short period of time. That feature largely explains the failure of that covenant.

Simply stating that an employee may not compete with the employer may work if the employer only offers one product or service, but it is more likely to fail when the employer offers a multitude of services or products. *Coates, supra.* In the latter case, a broadly drawn restriction is subject to serious legal challenge regardless of how the other elements are drawn.

Conclusion

The text identifying the restricted activity presents a more significant drafting challenge than the other elements. That restriction must closely reflect the industry or profession at issue, and the employee or seller’s exposure to customers/clients or confidential information. The restrictive terms are particularly difficult for a court to reform, so it is important to get it right the first time.

For more information about restrictive employment covenants, see our lead article on the subject, *COVENANTS NOT TO COMPETE IN MICHIGAN.* That article also references our companion articles on this subject.

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