

PROTECTING ORGANIZATIONAL GOOD WILL **AND BUSINESS ASSETS**

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I. NON-COMPETITION AGREEMENTS

A. History.

1. Until March 29, 1985 virtually all contracts that restricted employment were considered to be void and illegal as a restraint of trade.
2. The exception was a route or customer list. The non-compete was limited to a maximum of ninety (90) days.

B. The Michigan Antitrust Reform Act, MCLA 445.774a, states:

An employer may obtain from an employee an agreement or covenant which protects an employer's reasonable competitive business interest 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.

1. What is an employer's protectable interest?
 - a. The statute does not provide a definition.
 - b. The legislative analysis suggests that trade secrets, client lists and confidential employment materials are protectable.
 - c. A seminal case on trade secrets is *Hayes Albion Corp v Kuberski*, 421 Mich 170 (1984), rehearing denied, 42 Mich 1202 (1985).

- d. Goodwill and customers constitute a reasonable business interest. *Merrill Lynch v Grall*, 836 F Supp 428 (WD Mich, 1993).
- e. An agreement prohibiting an ex-stockbroker from soliciting customers he serviced while he worked for his former employer was reasonable because it lasted for one (1) year, did not prevent him from working as a broker and did not restrict him geographically from working. *American Express Financial Advisors v Scott*, 955 F Supp 688 (ND Texas, 1996).
- f. Customer lists, profit margins and pricing information are protectable. *Lowry Computer Products, Inc. v Head*, 984 F Supp 1111 (ED Mich 1997).
- g. A restrictive covenant entered into as part of an asset purchase agreement is protectable. *Perceptron, Inc. v Sensor Adaptive Machs, Inc.* 221 F 3d 913 (6th Cir 2000).

C. What are Non-Compete Agreements?

- 1. Agreements to restrict a certain type of business competition between an employer and its employees or a former owner of the business.
- 2. Names, types, or forms.
 - a. Non-compete agreements.
 - b. Restrictive covenants.
 - c. Non-solicitation agreements.
 - d. Similar to, but different from, non-disclosure agreements.
 - e. May be part of other standard employment agreements, including employment manuals, employment relationship statements, severance agreements, non-disclosure agreements, and release agreements.

D. Why use Non-Compete Agreements?

1. Use Non-Compete Agreements to protect legitimate business interests and to prevent unfair business competition.
2. Use to protect the tangible and intangible assets of a business as well as its goodwill.
3. Non-Compete Agreements help prevent unreasonable competition.
4. Non-Compete Agreements help obtain injunctive relief and monetary damages from unreasonable competition.
5. Employees have a legal duty of honesty and loyalty during their term of employment.
6. Employees have no legal obligation not to compete with you after their employment with you, absent a specific written agreement to the contrary.

E. When and How to use Non-Compete Agreements.

1. Non-Compete Agreements should be used as standard operating procedure or as standard method of operation in certain situations.
2. Non-Compete Agreements should be used with most higher level employees and with all independent contractors.
3. Non-Compete Agreements should be used often. There is rarely a reason not to use Non-Compete Agreements.
4. Non-Compete Agreements should be used in conjunction with other standard employment agreements, including employment manuals, employment relationship statements, non-disclosure agreements, severance agreements, and release agreements.

F. What are the elements of a Non-Compete Agreement?

1. There should be a specific restriction or prohibition concerning certain types of competition.

2. There should be a specific remedy and damages in the event of a breach or default of the restriction.
3. The restriction should protect reasonable and legitimate existing business interests and nothing more.
4. The restrictions must be reasonable as to:
 - a. Time or Term:
 - i. Six (6) months to five (5) years is usually thought of as reasonable and enforceable depending on the industry, position of the employee and the specific facts and circumstances of the matter.
 - ii. Ten (10) years to twenty (20) years is usually thought of as unreasonable and unenforceable.
 - iii. The shorter the time, the more reasonable and the more likely to be enforced.
 - b. Geography or Area:
 - i. One (1) mile to twenty (20) miles is usually thought of as reasonable and enforceable.
 - ii. Twenty-five (25) miles, a state, the nation, or the world may be viewed as unreasonable and unenforceable depending on the facts and circumstances.
 - iii. The shorter or smaller the geographic area, the more reasonable and the more likely to be enforceable.
 - c. Scope or Coverage:
 - i. Restriction should be limited only to legitimate business interests.
 - ii. Legitimate business interests include attempting to protect existing customers, clients, products, services, trade secrets, employees, contractors, and suppliers.

- iii. All potential customers, clients, products, services, and suppliers are usually thought of as unreasonable and unenforceable.
 - iv. The narrower the scope or coverage, the more reasonable and the more likely to be enforced.
 - 5. Restrictions should include:
 - a. Prohibition against competing with, contacting or soliciting actual and targeted customers or clients.
 - b. Prohibition against hiring or dealing with, contacting, or soliciting actual employees, contractors, and suppliers.
 - 6. Non-Compete Agreements should provide for damages in the event of a breach or default, which damages should specifically include, but not be limited to liquidated monetary damages and all costs of enforcing the agreement, including reasonable attorney fees.
 - 7. Non-Compete Agreements should provide for equitable remedies, which include injunctions and restraining orders.
- G. What should be avoided when using Non-Compete Agreements?
- 1. Like all written agreements, avoid those terms and restrictions which are unreasonable, over-reaching, and unfair.
 - 2. Unreasonable restrictions are:
 - a. Restrictions which prevent someone from:
 - i. Working in the only job or industry which an individual knows or has ever known, or
 - ii. Making a living, and
 - b. Restrictions which injure or interfere with another's legitimate business interests.

H. What are the problems with Non-Compete Agreements?

1. Non-Compete Agreements are not a guaranty or an absolute bar from unreasonable competition.
2. Non-Compete Agreements keep only honest people more honest. They will not keep dishonest employees from acting dishonestly.
3. Non-Compete Agreements should not be overly relied upon or used as a substitute for providing quality goods and/or services.
4. Non-Compete Agreements are "double-edged" and can run in both directions.
 - a. Employers must be very careful about hiring employees who may be subject to and bound by a Non-Compete Agreement.
 - b. Employers must carefully review and analyze all agreements which are signed by or bind prospective employees.

I. Enforcement.

1. To enforce a covenant not to compete, the plaintiff must be reasonable as to its duration, geographical area and type of employment or line of business.
2. Does signing a covenant not to compete at the beginning of an employment relationship provide sufficient consideration to make the covenant enforceable?

Yes. See *Lowry Computer Products, Inc. v Head*, supra.

3. Does the continuation of employment constitute sufficient consideration to enforce the covenant? Yes, under certain circumstances.
 - a. If a new business has acquired the old business which employed the employee. *Lowry Computer Products, Inc. v Head*, supra.
 - b. If a new contract is signed with the current employer. *Robert Half International, Inc. v Van Steemis*, 784 F Supp 1263 (ED

Mich 1991).

4. What are the factors that a court considers in determining the reasonableness of time and geographical restrictions?
 - a. With respect to time, periods from six (6) months to three (3) years have been considered reasonable. *Superior Consulting, Inc. v Walling*, 851 F Supp 847 (ED Mich 1994).
 - b. A five (5) year covenant barring a seller of a business from competing in the office furniture industry in Michigan and Ohio was deemed reasonable but was not enforced for other reasons. *In re Spradlin*, 284 BR 830 (ED Mich 2002).
 - c. Also, a five (5) year non-compete provision was enforceable as part of an asset purchase agreement prohibiting the seller from competing in the business of designing, developing, manufacturing, selling and servicing electro-optical measuring products. See *Sensor Adaptive Machs*, supra.
 - d. A three (3) year non-compete executed by independent sales representatives formerly employed by a replacement window company was reasonable. *Bristol Window & Door, Inc. v Hoogenstyn*, 250 Mich App 478 (2002)
 - e. The issue is fact sensitive to industries. In certain industries (i.e., computer hardware sales, sales of software) a shorter restrictive covenant period of one (1) year should increase the ability to enforce the covenant as written.
 - f. With respect to geography, the court in *Walling* held that an unlimited geographic scope is reasonable if the business at issue is international in scope.
 - g. Non-solicitation of the former employer's customers has been found to be a reasonable substitute for geographical restrictions.

5. If the covenant not to compete is too broad to render it enforceable, is the court permitted to modify the covenant to make the restriction more narrow and thus the covenant enforceable?

Yes. Michigan courts have discretion to modify unreasonable covenants.

6. Will a single breach of a covenant not to compete be sufficient for a court to issue an injunction extending the period of the covenant?

Normally, no. However, when a breach is continuous and systematic, courts have extended the time period of a covenant.

7. What elements does a court consider to determine if an employer is entitled to obtain a preliminary injunction enforcing a covenant not to compete?

- a. Whether the public interest will be harmed if an injunction is issued.
- b. Whether the plaintiff employer will be harmed, if temporary relief is not granted, more than the opposing party (i.e. - former employee).
- c. Whether the plaintiff is likely to prevail on the merits.
- d. Whether the plaintiff will be irreparably harmed if the relief is not granted (monetary damages will not be an adequate remedy).
- e. Whether granting the injunction will preserve the status quo.

8. What choice of law rule applies in determining which state law governs in determining whether to enforce a covenant not to compete?

- a. In *Lowry Computer Products, Inc. v Head*, 984 F. Supp 1111 (ED Mich 1997), a federal court in the Eastern District of Michigan held:

In determining the state of applicable law in the absence of an effective choice of law by the parties pursuant to ...courts take into account the place of contracting, the place of negotiation of the contract, the place of performance, the location of the subject matter of the contract, and the domicile, residence, nationality, place of incorporation and place of business of the parties.

Id. at 11.

II. NON-SOLICITATION AGREEMENTS

A. What are Non-Solicitation Agreements?

1. Similar to non-compete agreements, non-solicitation agreements restrict a type of business competition between an employer and its employees.
2. In non-solicitation agreements, the employee agrees not to solicit either or all of:
 - a. Other employees in the protected business.
 - b. Clients and/or customers.
 - c. Vendors, suppliers and business contacts.
 - d. In some cases, the employee agrees not to do business with a former client and/or customer even if the employee did not solicit the person or business.

B. Why use Non-Solicitation Agreements?

1. Protection of legitimate business interests.
2. Helps prevent unfair and/or unreasonable competition.
3. May result in injunction relief and monetary damages from a violator of the agreement.
4. Courts generally find non-solicitation agreements easier to enforce than non-competition agreements.

C. When and How to Use Non-Solicitation Agreements?

1. Non-solicitation agreements should be used as standard operating procedure or as standard method of operation in certain situations.
2. Non-solicitation agreements should be used with most higher level employees and with all independent contractors.
3. Non-solicitation agreements should be used even in certain situations where a non-compete agreement is not used.

D. Elements of a Non-Solicitation Agreement.

1. The employee agrees not to solicit, initiate contact or, in some cases, not accept new business from existing or targeted clients, customers, vendors and/or employees in the business for a specific period of time.
2. The agreement must be reasonable as to time, similar to non-compete agreements.
3. The agreement should be tied to protect reasonable and legitimate existing business interests and nothing more.
4. There should be a specific remedy and damages in the event of a breach or default of the restriction, including reasonable attorneys fees.
5. The agreement should provide for equitable remedies, which include entry of injunctions and restraining orders.

E. What are the problems with Non-Solicitation Agreements?

1. Similar to non-compete agreements, the agreements are not a guarantee or absolute bar from unreasonable competition.
2. Similar to non-compete agreements, the agreements are "double edged" and may present a problem for an employer who wants to hire an employee subject to a non-solicitation agreement.

F. Enforcement.

1. Easier to enforce than non-compete agreements because the agreements are more limited in scope and less problematic for an

- employee to comply with.
2. The time period still must be reasonable.
 3. The cases pertaining to non-compete agreements are relevant to non-solicitation agreements as well.

III. NON-DISCLOSURE AGREEMENTS

A. What are Non-Disclosure Agreements?

1. Agreements to restrict the disclosure of certain types of business information between an employer and its employees.
2. Types.
 - a. Non-disclosure agreements
 - b. Confidentiality agreements
 - c. Secrecy agreements
 - d. Similar to, but different from, non-compete agreements
 - e. May be part of other standard employment agreements, including employment manuals, employment relationship statements, severance agreements, non-compete agreements, and releases.

B. Why use Non-Disclosure Agreements?

1. Non-Disclosure Agreements protect the unauthorized disclosure of legitimate business information.
2. Non-Disclosure Agreements protect business information which is:
 - a. Not generally known by anyone outside of your business:
 - i. Competitors.
 - ii. General public.
 - b. Information which is confidential, secret, and proprietary.
3. Non-Disclosure Agreements help prevent unnecessary disclosure of

confidential information.

4. Non-Disclosure Agreements help the company obtain injunctive relief and monetary damages for the unauthorized disclosure of protected business information.
5. Employees owe a legal duty of honesty, loyalty and confidentiality to their employer while they are employed.
6. Employees have no legal duty or obligation of honesty, loyalty, or confidentiality after their employment, absent a specific written agreement to the contrary.

C. When and How to Use Non-Disclosure Agreements

1. Non-Disclosure Agreements are recommended as standard operating procedure or as a standard method of operation.
2. Non-Disclosure Agreements should be used with all employees as well as with all independent contractors.
3. Non-Disclosure Agreements should be used almost all the time. There is virtually no downside to using Non-Disclosure Agreements.
4. Non-Disclosure Agreements should be used in conjunction with:
 - a. Other standard employment agreements, including employment manuals, employment relationship statements, non-compete agreements, severance agreements and releases.
 - b. Other common sense employment practices, which are consistent with and reinforce the desire to fully protect the confidential information.
5. Employment practices which should be used to support and reinforce the terms and intent of the Non-Disclosure Agreement:
 - a. Stamping documents "Confidential," and
 - b. Customizing computer software for:
 - i. Log-on with special confidential acknowledgment,

- ii. Printing all confidential documents with a confidentiality statement on all pages thereof.
 - c. Conducting periodic in-house training, orientation, and/or education seminars which explain the non-disclosure obligations and importance thereof.
- D. What are the Elements of a Non-Disclosure Agreement?
 - 1. Non-Disclosure Agreements should acknowledge that the employer is the sole and exclusive owner of the information.
 - 2. Non-Disclosure Agreements should acknowledge the desire and need to retain all such business information confidential and not to disclose it to anyone whatsoever.
 - 3. Non-Disclosure Agreements should cover and prohibit the unauthorized disclosure of all business information, which should specifically include information which is confidential and non-confidential, secret and non-secret, proprietary and non-proprietary, and generally known and not known.
 - 4. Non-Disclosure Agreements should acknowledge that the information may only be used for the benefit of the employer and for no other person or purpose whatsoever.
 - 5. Non-Disclosure Agreements should require the return of all such business information upon termination of employment or demand.
 - 6. Non-Disclosure Agreements should provide for injunctive remedies and monetary damages for a breach or default of the restrictions, which should specifically include, but not be limited to liquidated monetary damages in a specific dollar amount and all costs of enforcing the agreement, including actual attorney fees.
- E. What Should be Avoided When Using Non-Disclosure Agreements?
 - 1. Like all written agreements, avoid those terms and provisions which are unreasonable, unrealistic, or unfair.

2. With Non-Disclosure Agreements, there is nothing to avoid. Every employer needs to have them and use them.
3. Typical exclusions or omissions may include:
 - a. Information which is generally available or known in the public.
 - b. Information legally obtained from other sources or third parties, and not the employer.
 - c. Information which the employee had knowledge of prior to employment.

F. What are the Problems With Non-Disclosure Agreements?

1. Non-Disclosure Agreements are not a guaranty or an absolute bar from the disclosure of confidential business information.
2. Non-Disclosure Agreements keep only honest people more honest. They will not keep dishonest employees from acting dishonestly.
3. Non-Disclosure Agreements should not be overly relied upon.
4. Non-Disclosure Agreements are "double-edged" and can run in both directions.
 - a. Employers must be very careful about hiring employees who may be subject to and bound by a Non-Disclosure Agreement.
 - b. Employers must carefully review and analyze all agreements which are signed by or bind prospective employees.

IV. TRADE SECRETS

A. Uniform Trade Secrets Act ("UTSA").

1. Broader than Michigan trade secret law insofar as it covers programs, methods and techniques as well as employee know how.
2. UTSA applies to any wrongful misappropriation where Michigan law focuses on the deterrence of unethical business practice and conduct.

B. Michigan Law.

1. Up to 1985, Michigan trade secret law was developed in accordance with the State's covenant not to compete statute.
2. For information to be protected, it must be secret. Secrecy alone is not sufficient to establish a trade secret but without this element, a plaintiff may be unable to prevail.
3. In *Kubik, Inc. v Hull*, 56 Mich App 335 (1974) (a pre-Michigan Antitrust Reform Act case), the court determined the following factors to be relevant in evaluating a secrecy case:
 - a. The existence or absence of an express agreement concerning disclosure
 - b. The nature and extent of security precautions used to prevent disclosure to unauthorized third parties
 - c. The circumstances surrounding disclosure to the employee so that the employee understood the significance of not disclosing to others
 - d. The degree to which the information is in the public domain or readily ascertainable by or through patent applications or product marketing

C. Enforcement.

1. Seeking injunctive relief is frequently the remedy that an injured plaintiff attempts.
2. Much like covenant not to compete cases, a party may seek actual damages sustained as a result of the violation of the Michigan Antitrust Reform Act, including interest from the date of the complaint, costs and reasonable attorney fees. MCL 445.778(2).
3. If the violation is "flagrant" a trier of fact may award damages up to three times the amount of actual damages sustained. *Id.*

D. Is there a criminal statute that defines trade secrets?

1. Yes. MCL 752.772 states:

Any person who, with intent to deprive or withhold from the owner thereof the control of a trade secret, or with an intent to appropriate a trade secret to his own use or to the use of another, steals or embezzles an article representing a trade secret or without authority makes or causes to be made a copy of an article representing a trade secret, is guilty of a misdemeanor and shall be fined not more than \$1,000.00 or imprisoned for not more than 1 year, or both.

2. Trade secret is defined as "the whole of any portion or phase of any scientific or technical information, design, process, procedure, formula or improvement which is secret and of value; and a trade secret is considered to be secret when the owner thereof takes measures to prevent it from becoming available to persons other than those selected by the owner to have access thereto for limited purposes."

V. ECONOMIC ESPIONAGE ACT OF 1996 ("the Act")

A. The Act.

1. It is a federal crime to engage in the conduct of misappropriating a trade secret knowingly, for the benefit of foreign and domestic entities.
2. To prove a violation of the Act, intent and conduct must be established.

B. Conduct.

1. Stealing, or without authorization, taking, carrying, concealing, or by fraud or deception obtaining such information.
2. Without authorization, copying, duplicating, drawing, photocopying, downloading, uploading, destroying, altering, sending, mailing, communicating or conveying such information.
3. Receiving, buying, or possessing such information knowing same has been stolen or appropriated, obtained or converted without authorization.

4. Conspiring with others to commit the acts described above.

C. Intent.

In addition to establishing conduct, intent to convert "a trade secret that is related to or included in a product that is produced for and placed in interstate or foreign commerce to the economic benefit of anyone other than the owner" must be proven.

D. Penalties.

A violation could result in a fine for an individual up to \$500,000 or imprisonment up to 15 years, or both. An entity found in violation of the Act may be liable for a fine up to \$10 million and may be required to forfeit property derived from illegal conduct.

E. Safeguards.

1. Employers, when hiring an employee directly from a competitor, should advise the new employee in writing that he/she is obligated to protect the trade secrets of the former employer and confirm that the Act has been explained to them.
2. The new employee should execute an agreement confirming that they are not contractually or otherwise prohibited from performing their new duties.

VI. INTELLECTUAL PROPERTY RIGHTS

A. Introduction.

1. Work made for hire deals with ownership of copyrightable material between an employer and employee, or independent contractor.
2. When a work for hire agreement is in place, the employer owns the ability to copyright material created by an employee within the scope of his employment, or an independent contractor pursuant to an order or commission from the employer.

3. There is a presumption that the author of a work is the owner of the copyright to that work. Therefore, it is important for employers to include work made for hire language in employment agreements.
4. Employers can run into trouble when a clear work for hire agreement is not in place and a question of the ownership of a copyright arises.

B. Definition.

1. The phrase “work made for hire” is a statutorily defined term at 17 USC §101 and is defined as:
 - a. A work prepared by an employee within the scope of his or her employment, or
 - b. A work specially ordered or commissioned for use as
 - i. a contribution to a collective work,
 - ii. as a part of a motion picture or other audiovisual work,
 - iii. as a translation,
 - iv. as a supplementary work,
 - v. as a compilation,
 - vi. as an instructional text,
 - vii. as a test,
 - viii. as answer material for a test, or
 - ix. as an atlas,
 - c. if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire. For the purpose of the foregoing sentence, a supplementary work is a work prepared for publication as a secondary adjunct to a work by another author for the purpose of introducing, concluding, illustrating, explaining, revising, commenting upon, or assisting in the use of the other work, such as forwards,

afterword, pictorial illustrations, maps, charts, tables, editorial notes, musical arrangements, answer material for tests, bibliographies, appendixes, and indexes, and an “instructional text” is a literary, pictorial, or graphic work prepared for publication with the purpose of use in systematic instructional activities.

C. How is “employee” defined for purposes of work for hire?

1. The Supreme Court has held in the notable case, *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989), that for purposes of applying the definition of work made for hire, an “employee” is generally defined pursuant to the common law of agency, and the following aspects of control that an employer may exert over a worker should be considered:
 - a. The extent of control by the employer over the work,
 - b. The extent of control by the employer over the employee, and
 - c. The status and conduct of the employer,
 - i. Is the employer in business to produce such works, and does it provide the employee with benefits and withhold taxes?

D. What must be included in an agreement with an independent contractor when making a work made for hire agreement?

1. The work must be specially commissioned and new, not something previously prepared,
2. The work must fall into one of the nine categories outlined in the statute,
3. There must be a writing between the parties, prior to the creation of the work, specifically stating that the parties are agreeing to a work made for hire arrangement, and

4. The writing must be signed by both parties.
- E. Because not all work falls within one of the nine statutory categories of work made for hire, employers should also include more general language assigning the copyright/intellectual property rights to the employer as an additional measure to ensure ownership of contracted-for work.
1. This extra language is necessary because not all work is considered work made for hire, regardless of whether there is a writing stating as much.
 2. The work made for hire agreement should include “belt and suspenders” language that assigns ownership rights of all material created by the worker, that pertains to the employer’s business, to the employer so that the employer does not have to determine whether the work falls into a specific section of the definition, and regardless, ownership of the work is assigned to the employer.
 - a. This type of catch all is more akin to an assignment of all intellectual property rights of material created by the worker and would ideally include the following points:
 - i. An assignment to the employer of the employee’s right to any ideas, inventions, discoveries, improvements, and works of authorship relating to the employer’s business.
 - ii. An agreement to assist the employer in preparing documents for the protection of intellectual property rights, such as powers of attorney, affidavits, patent application and copy right registrations.
 - iii. Cooperation by the employee in the assignment and delivery of all necessary papers, including assignments of patent applications and patents.
 - iv. An agreement to give all information and testimony, sign all papers, and do all things whatsoever which may be

requested by the employer to obtain, extend, reissue, maintain or enforce such intellectual property rights.

- F. Pitfall of characterizing something as work made for hire.
1. Employers could run into unforeseen obligations toward workers by characterizing work as work made for hire under subsection one, in an attempt to avoid the lack of a written agreement as required under subsection two.
 - a. If a worker is not otherwise considered an employee, but an employer is characterizing a work as work made for hire under the first section of the definition, this could impose a responsibility on the employer for workers compensation insurance, unemployment compensation, and other benefits that a worker may not otherwise be eligible for.
 2. When working with an independent contractor who may be using third party copyrighted material in his creation of a work made for hire, an employer should be sure to include in any agreement a condition requiring all permission letters for the use of third party copyrighted material prior to final payment.
 - a. This will avoid the messy situation of an employer having to ask for third party permission to use material produced for the employer.
 3. Employers should include work made for hire language and assignment of copyright language in any employment agreement or independent contractor agreement to avoid the pitfalls mentioned above.