NON-COMPETE AND NON-DISCLOSURE AGREEMENTS

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I. NON-COMPETE 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 list. The ability to 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).

C. What are Non-Compete Agreements?

1. Agreements to restrict a certain type of business competition between an employer and its employees.

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.

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 the 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.

2. Non-Compete Agreements should be used with most 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. Draft or edit restriction to protecting reasonable and legitimate existing business interests and nothing more.

4. The restrictions should be reasonable as to:

a. Time or Term

i. Six (6) months to five (5) years, usually thought of as reasonable and enforceable depending on the industry and position of the employee.

ii. Ten (10) years to twenty (20) years, 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, 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.

iii. The shorter or smaller the geographic area, the more reasonable and the more likely to be enforceable.

c. Scope or Coverage

i. Restriction limited to legitimate business interests.

ii. Legitimate business interests include attempting to protect existing customers, clients, products, services, employees, contractors, and suppliers.

iii. <u>All potential</u> customers, clients, products, services, and suppliers 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. Prohibitions against competing with, contacting or soliciting <u>actual</u> 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 actual 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. The issue is fact sensitive to industries. In certain industries (i.e., computer hardware sales) a shorter restrictive covenant period might increase the ability to enforce the covenant as written.

c. 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.

d. Non-solicitation of any 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 do a court review to determine if an employer is entitled to obtain a preliminary injunction enforcing the covenant not to compete?

a. The public interest will be harmed if the injunction is issued.

b. The plaintiff will be harmed, if temporary relief is not granted, more than the opposing party.

c. The plaintiff is likely to prevail on the merits.

d. The plaintiff will be irreparably harmed if the relief is not granted.

e. 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 stated:

> 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-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 agree-ments, and release agreements.

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-Compete Agreements help you obtain injunctive relief and monetary damages for the unauthorized disclosure of protected business information.

5. Employees have a legal duty of honesty, loyalty and confidentiality 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 should be used as standard operating procedure or as a standard method of operation.

2. Non-Disclosure Agreements should be used with <u>all employees</u> and with <u>all independent contractors</u>.

3. Non-Disclosure Agreements should be used <u>all the time</u>. There is almost no downside to 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.

III. 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."

IV. New Hires and Old Employment Agreements

A. G – R – A – P – E – S

1. Get the employment agreement.

2. Review the employment agreement.

3. Affirm the employment agreement's restrictions with the employee if applicable.

4. Prevent data migration.

5. Explore negotiations with the former employer.

B. S – N – A – P

1. Study your employment agreement.

2. Notify the new employer of the employment agreement.

3. Acquire as much information as possible.

4. Prevent reliance by employee upon "deep pockets."