

An Introduction to Non-Compete Agreements (Part 1 of 2)

[This is the first part of a two-part article. This first installment will cover the basic definition of a non-compete agreement, the fact that such agreements are enforceable in Indiana and Michigan, and why you as an employer or business owner should care. The second installment will expand on enforceability issues under Indiana and Michigan law and provide some basic fact patterns where such an agreement might be more or less likely to be enforced by a court.]

If you own or operate a business and have employees, you have likely come into contact, in one way or another, with what is often referred to generically as a “non-compete agreement.” As a business manager who either has current employees or any plans to have employees in the future, it is important that you understand what a non-compete agreement is, what a non-compete agreement can and cannot do for your business, and how your current or future employee’s non-compete agreement with a former employer could create significant legal issues for your business even though your business is not a party to that agreement.

Although often referred to by the generic phrase “non-compete agreement,” in our experience when the typical business person comes to us to discuss a non-compete agreement they often have in mind an agreement which encompasses a number of different restrictions on the employee’s activity both during the term of his employment and after the termination of his employment. These restrictions may be included as part of an employment agreement, as provisions in an employee handbook, or in a separate agreement dedicated solely to that purpose. These restrictions potentially include separate covenants against competition with the business of the employer, solicitation of some or all of the business’ customers, solicitation of some or all of the business’ other employees, solicitation of some or all of the business’ suppliers, and separate covenants to maintain the confidentiality of and not to disclose to third parties certain confidential or proprietary information that may have been available to the employee as a result of his or her employment. These various non-competition, non-solicitation, and confidentiality obligations are often described in the agreement as being limited in some fashion as to the scope of the restricted activity, the geographic scope of the limitation, and the length of time the limitation will remain in effect after the termination of the employee’s employment.

In addition to the typical employee non-compete agreement described above, there is another main type of non-compete agreement that many business owners may

encounter either when they buy their business or sell their business. This is often referred to as a “non-compete agreement ancillary to the sale of a business”. Although the line between these two types of non-compete agreement can sometimes be blurry, the non-compete agreement ancillary to the sale of a business is typically entered into by the owners of the business in connection with the sale of the business to another party, and is provided by the selling owners for the benefit and protection of the new owners.

The single most important reason you should be aware of and at least minimally knowledgeable about non-compete agreements is this: ***Non-compete agreements, if properly drafted and used in the appropriate factual circumstances, are enforceable in both Indiana and Michigan. This applies to both traditional employee non-compete agreements and to non-compete agreements ancillary to the sale of a business.***

The fact that these agreements are enforceable in Indiana and Michigan may come as a surprise to some of you. We sometimes hear from business owners that such agreements are a “waste of time” and aren’t “worth the paper they are written on,” and consequently many business owners may make one of two mistakes. First, the business owner may fail to have the business’ employees sign non-compete agreements even when doing so could well be appropriate for the employer’s facts and circumstances, be an important protection for the business, and even add significant value to the business for purposes of a future sale or other transfer of the business at some point down the line. Second, the business owner may fail to properly consider and respond when the owner becomes aware that a current employee or a prospective future employee is a party to a non-compete agreement with the current or prospective employee’s former employer.

In the first instance, the business owner may have missed out on a relatively inexpensive opportunity to put in place reasonable and necessary protections against its employees’ future conduct and may subsequently suffer significant damage to its business from conduct of a former employee that could have been avoided or reduced. In the second instance, the business owner may miss an opportunity to avoid becoming entangled in potentially expensive and time-consuming litigation initiated by the former employer against both the employee and the business owner as a result of the employee’s violation of his obligations to his former employer under his non-compete agreement.

As I’ve noted, non-compete agreements are enforceable in Indiana and Michigan, but only to the extent that they are being enforced in appropriate factual

circumstances and have been drafted so that their restrictions are as narrow as reasonably necessary to protect the business's legitimate interests. In Part 2 of this article, I'll discuss some of the elements of enforceability of non-compete agreements in greater detail and will also provide some hypothetical fact patterns where non-compete agreements might be more or less likely to be enforced by a court.

Please note that the above discussion is intended only as a summary and should not be relied upon to determine the enforceability of any individual non-compete agreement, since the enforceability of a non-compete agreement is highly dependent on the individual facts and circumstances of the employer, the employee, and the actual language of the non-compete agreement.



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This article is for informational purposes only and should not be relied upon as legal advice. If you are in need of assistance with the preparation or review of a non-compete agreement, you should seek the advice of a legal professional.