The Enforcement of Business-to-Business Non-Compete Agreements is Measured by a Different Legal Standard: While You Might Not Need to Know This, Your Lawyer Should

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While non-compete agreements are regularly used in the employer-employee context and enforcement disputes surrounding those types of agreements often make headlines, a lesser known, but certainly regular, use of non-compete agreements can be found in many other settings, including the sale of a business or other commercial transactions where one company or party agrees to restrictive covenants on a going forward basis. In fact, some business disputes are resolved where such an agreement might be used.

That was the situation in a recent decision issued by a federal court in Detroit. Judge Terrence G. Berg, in *Innovation Ventures, LLC v Custom Nutrition Laboratories, LLC, et al.,* 2020 WL 1531700 (March 31, 2020), was asked to enforce a 20 year non-compete agreement entered into between the parties pursuant to a settlement agreement involving a prior dispute. The settlement agreement restricted defendants from using any ingredients in a particular chemical family in producing their energy drinks, which were viewed as competitive with those of the plaintiff. See here.

In a well-reasoned opinion, Judge Berg set forth the standard by which those business-to-business agreements should be evaluated when seeking enforcement. In grappling with the issues concerning enforcement of the particular provision before the court, Judge Berg conducted a thorough and comprehensive review of the history of non-complete law in Michigan, beginning with an 1873 Michigan Supreme Court decision.

In an earlier decision by Judge Berg in the dispute, one written prior to an opinion by the Michigan Supreme Court which first held that business-to-business non-compete agreements are

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measured by the rule of reason analysis used in antitrust disputes (*Innovation Ventures v Liquid Manufacturing*, 499 Mich. 491, 885 N.W.2d 861 (Mich. 2016)), Judge Berg ruled that the 20 year length of the non-compete agreement was unreasonable, but that it was reasonable as to geographic scope and type of business restricted. As such, and as allowed under MCLA §445.77a(1), a section of the Michigan Antitrust Reform Act ("MARA"), he modified the temporal provision to 3 years.

That provision of MARA set forth the standards by which courts and practitioners have for some time evaluated the enforceability of non-compete agreements in both the employer-employee context and that involving business-to-business non-compete disputes. Under that standard, the non-compete agreement must protect a party's reasonable competitive business interests and its protection must be reasonable with respect to duration, geographical scope and the line of business restricted.

Under the rule of reason standard, courts are directed to a similar, yet different analysis. Judge Berg was offered competing views of that standard by the parties in the litigation. In evaluating the proper rule of reason standard, the court had to determine what the applicable limits and parameters were of the rule of reason as decided by Michigan courts. Defendants claimed that the standard under the MARA provision was a codification of the rule of reason and should be applied. The plaintiff argued that that was not the standard and that the Sherman Antitrust Act and jurisprudence under that act should guide the court's analysis of a rule of reason analysis, including that the court also consider the impact of the non-compete on competition.

In reaching its decision on the appropriate standard to be applied under the rule of reason analysis, and whether the 20 year non-compete would be enforced, the court explored the history of that rule under Michigan law. Judge Berg concluded that this history showed that the analysis would require that a party challenging a restrictive covenant must also demonstrate that the clause causes some harm to competition in the greater product market. "This effect on the greater market appears to be most substantial difference between the showing that must be made under [the MARA standard] and that which would be required under the rule of reason framework."

While that analysis would include consideration of the duration, geographical scope and reasonableness between the parties, the court would also have to consider the restrictive covenant's impact on competition in the wider market. Specifically, the court set forth the test for this evaluation:

1. Whether this restraint is ancillary to the main business purpose of an otherwise lawful contract;
2. whether the restraint protects legitimate property interests, for example, goodwill;
3. whether the restraint's duration, geographic reach, and scope are reasonable considering the nature of the property interest being protected; and
4. whether the restraint suppresses or destroys competition in the relevant market.

In applying this analysis to the case before it, Judge Berg concluded that he had insufficient evidence in relation to the last element of that analysis; that is, whether the restraint suppresses or destroys competition in the relevant market. The court denied the cross dispositive motions submitted by the

parties and directed the parties to engage in discovery on that issue.

In the end, while the analysis of a business-to-business non-compete dispute is somewhat similar to that of an analysis conducted under an employer-employee context, it is not the same. Indeed, the proper analysis also requires that a court evaluate the anticompetitive effect of the restrictive covenant and whether it touches upon or harms competition. Butzel's Trade Secret and Non-Compete Specialty Team is well versed in this area of the law and is prepared to represent your interests. Whether your needs involve enforcing a non-compete or counseling and drafting these types of restrictive covenants so that it is more likely that the provision would be enforced by a court, or whether you find your company on the defensive side of this type of dispute and are challenging the enforceability of an agreement, our lawyers keep abreast of the constantly changing nuances in this specialized area of the law and can meet your needs.

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