

ARE GEOGRAPHIC RESTRICTIONS IN NONCOMPETITION AGREEMENTS MEANINGFUL IN THE INFORMATION AGE?

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Those who participate in a business enterprise as partners, employees, or otherwise, usually acquire information and skills that are vital to the enterprise's success. When partners or employees depart, they could use such assets in competition against the enterprise, either on their own or with a competitor. Companies have long sought to prevent such competition and as protection against it, have required partners and employees to enter into noncompetition agreements. However, such agreements occupy a difficult legal position. From one perspective, they seek to protect valuable assets belonging to the enterprise—items fairly characterized as the enterprise's property. Agreements to protect property interests alone create no particular legal problems, but agreements to restrict competition do; they are the hallmark of the monopoly and the cartel. And noncompetition agreements may be seen in this light. Consequently, the law views them with great skepticism.

Most states resolve the dilemma of noncompetition agreements by permitting them only in particular circumstances: when they were applied to a limited range of business activities, had a limited duration, and limited geographic scope. However, in light of some recent judicial opinions under Michigan law, coupled with the technological transformation of business, there is a question of whether the factor relating to the geographic restriction continues to play a meaningful role in determining the validity of noncompetition agreements in Michigan.

HISTORY OF MICHIGAN LAW

Michigan has a rather short history of allowing noncompetition agreements, and this history (or its absence) may play some role in shaping the contemporary law. For most of this century, Michigan prohibited noncompetition agreements, with two exceptions, as "against public policy, illegal and void." 1905 PA 329, MCLA 445. 761 *et seq.* (repealed by Michigan Antitrust Reform Act, 1984 PA 2 74, MCLA 445. 771 *et seq.*). Michigan law essentially outlawed almost all agreements by which a person agreed not to compete in a business or in profession. See *Compton v. Lepak*, 154 Mich. App. 360, 364-65 (1986). The law presumed that any noncompetition agreement undermined the free market and constituted an unacceptable restraint of trade. In this respect, Michigan differed from the majority of states, which recognized the validity of noncompetition agreements in the limited circumstances noted above.

In 1985, with the repeal of 1905 PA 329, Michigan joined the majority of states by removing its sweeping prohibition against noncompetition agreements. Later, through a statute enacted in 1987, the Michigan legislature began to provide some guidance as to how Michigan would move forward in this new era. That statute suggests that the enforceability of any noncompetition agreement should turn on the analysis of the employer's competitive business interest, and the reasonableness of the duration, geographic area, and the type of employment or line of business prohibited by the agreement. However, MCLA 445.774a does not clarify how each of these elements will or should be considered in assessing the validity or enforceability of a noncompetition agreement.

INTERPRETATION OF MCLA 445.774A

Because it is relatively new, MCLA 445.774a has not been frequently interpreted by the courts. However, two recent cases seem to have ignored the statute's apparent suggestion that a limited geographic application is a necessary aspect of a noncompetition agreement. In both of these cases, courts have been confronted with noncompetition agreements that were subject to Michigan law and were unlimited in their geographic scope. Although these courts found problems with certain aspects of the agreements, they were untroubled by the lack of any geographic restriction. A review of these cases may suggest some reasons why an apparently crucial aspect of the statute has been ignored.

Article: Are Geographic Restrictions in Noncompetition Agreements Meaningful

In *Superior Consulting Co., Inc. v. Walling*, 839 F. Supp. 839 (E.D. Mich. 1994), an employer provided information systems and management consulting services to multi-facility health care institution, and the employee was an executive who specialized in client consulting. The employee had signed a noncompetition agreement that included three crucial provisions: he agreed not to solicit business from his employer's clients for ninety days after the end of his employment; he agreed not to work for one of his employer's competitors in the healthcare information systems consulting business for six months after the end of his employment; and he agreed not to use confidential information acquired through his employment. The employee resigned and took a position with one of his employer's competitors, and the employer sought a preliminary injunction to enforce the terms of the noncompetition agreement.

In discussing the absence of any geographic restriction in the agreement, the court noted that the geographic scope of a noncompetition agreement must be no greater than is reasonably necessary to protect the employer's legitimate business interests. Because the employer did business in forty-three states and a number of foreign countries, the court concluded that it was reasonable to give the agreement a worldwide scope.

The court in *Frontier Corp. v. Telco Communications Group, Inc.*, 965 F. Supp. 1200 (S.D. Ind. 1997) reached a similar conclusion. In that case, the employer provided long-distance telephone services to small businesses around the world. It entered into noncompetition agreements with its sales staff whereby the staff agreed not to solicit any of the employer's customers anywhere in the world. The agreements were governed by Michigan law. Some employees resigned and took positions with a competitor, and the employer sued to enforce the noncompetition agreements. The employees challenged the validity of the agreements, arguing, among other things, that they were defective because they lacked a geographic limitation. The court rejected this argument, adopting the reasoning employed in *Superior Consulting*.

The analysis in *Frontier* contains a flaw which deserves attention. The court characterized the agreement in that case as a "noncompetition agreement," but the court's own recitation of the facts suggests that this characterization is incorrect. The agreement did not prevent employees from competing against the employer or from working for the employer's competitors; it prevented them from soliciting the employer's customers. Thus, the agreement may be more accurately described as a nonsolicitation agreement, which prevents the employee from doing business with certain kind of business. By its express language, MCLA 445.774a only applies to agreements that affect an employee's ability to engage in a line of business. Despite the analytical flaw, *Frontier* adds an endorsement to the idea that a noncompetition agreement may have an unlimited geographic scope as long as the employer's competitive business interests extend worldwide.

WHERE DOES A COMPANY "DO BUSINESS"?

In both *Superior Consulting* and *Frontier*, the courts accepted the premise that many businesses operate on a nationwide, and even worldwide basis, and that legitimate competitive business interests which such businesses may protect need not be limited in geographic scope. This assumption about the nature of competitive business interests may apply quite broadly, given the transformation of business effected by the computer and other elements of contemporary technology. Companies are no longer restricted to establishing relationships and transacting business close to home. As a practical matter, almost any enterprise may do business on a worldwide basis. Through the expanded use and success of the Internet and telemarketing, companies are transacting business with customers and suppliers all over the country, and all over the world, without leaving their offices, or sometimes their homes. Simply, it is not unreasonable to say that any business that establishes a website has legitimate competitive business interests all around the globe.

In light of these facts, it seems evident that the geographic restriction will not usually be the dispositive factor in the analysis of noncompetition agreements. Instead of protecting vaguely defined business interests in precisely defined geographic spheres, the noncompetition agreement of the Internet and telemarketing era may protect precisely defined interests worldwide. The location where a prohibited business activity takes place has taken a backseat to the business activity itself and the competitive business interests to be protected by the noncompetition agreement.

COMPETITIVE BUSINESS INTERESTS

As a geographic scope of protectible competitive business interests expands, the definition of those interests must become more precise. In both *Superior Consulting* and *Frontier*, the noncompetition

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agreements protected particular competitive business interests. It is likely that those courts would not have endorsed noncompetition agreements of unlimited scope if the protected interests were not so narrowly defined. However, Michigan courts have not yet clearly defined what are reasonable competitive business interests. Protection of trade secret information unquestionably qualifies as a reasonable competitive business interest under MCLA 445.774a. See *Hayes-Albion v. Kuberski*, 421 Mich. 170 (1984). Also, case law suggests that limited protection of the employer's customer relationships are good will may be allowed. Overall, it appears that courts will endorse reasonable restrictions on a departing employee's use of information, which represents a company's investment in proprietary materials and strong customer relationships. Obviously, the list of legitimate competitive business interest may expand as the case law interpreting MCLA 445.774a develops.

ARE GEOGRAPHIC RESTRICTIONS OBSOLETE?

Geographic restrictions in noncompetition agreement have not lost all meaning in the information age. The nature of competition in certain fields of enterprise has not been revolutionized by technology. Physicians, lawn care providers, hair stylist, restaurateurs, and other service providers are still site bound in providing services. Check-ups, hair cuts, lawn mowing and sit-down dinner are not available through a modem. In competitive environments like these, customer relationships, and therefore competition, have an identifiable geographic dimension. Such businesses will still need to include geographic limits in their noncompetition agreements because competition by the ex-employee at a specific location would have an adverse impact on the business of the ex-employer. These types of enterprises are in the minority, however. Accountants, stockbrokers, financial analysts, all kinds of consultants, computer programmers, sales people, and the vast majority of commercial services and products can now be provided at a distance. Through the use of e-commerce and a telephone, most services and products can be provided to customers from the building next to an ex-employer's business, or in an office a half a world away. As such, one may doubt the need for, and effectiveness of, geographical restrictions in noncompetition agreements in these fields.

CONCLUSION

In drafting noncompetition agreements, an employer should first consider the nature of its enterprise. If the enterprise depends upon bringing customers to a particular place, or performing services at a particular place, a geographic limitation is a necessity. If, on the other hand, the enterprise can provide its goods or services from, or to, any geographical location, or competes around the world, the reasoning of *Superior Consulting* and *Frontier* suggests that no geographical restriction would be necessary. However, as the geographic scope of the employer's business activity expands, the nature of the competitive business interests protected should be more narrowly defined. Simply, it is what you are protecting that really counts, not where you are protecting it. As such, companies today are increasingly using nonsolicitation and confidentiality agreements to protect their customers and proprietary information from use by ex-employees. This trend should continue in light of the courts' apparent focus on protecting a legitimate competitive business interest, and not a place. A company that seeks to protect itself from competition by former employees in the information age should rely less on the geographic area in which it seeks to prevent activity, and focus on the interests to be protected and the activity to be prohibited.

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