

APPELLATE**MICHIGAN SUPREME COURT HOLDS THAT THE FEDERAL "RULE OF REASON" APPLIES IN EVALUATING THE ENFORCEABILITY OF NONCOMPETE AGREEMENTS BETWEEN BUSINESSES**

by Phillip J. DeRosier

The Michigan Antitrust Reform Act (MARA) contains a specific provision, MCL 445.774a, that governs the enforceability of noncompete agreements between employees and employers. MARA does not, however, provide standards for evaluating noncompete agreements between two business entities. For many years, the Michigan Court of Appeals has nevertheless reviewed commercial noncompete provisions under MCL 445.774a. In the recent case of *Innovation Ventures, LLC v Liquid Manufacturing, LLC*, the Michigan Supreme Court held that this was error, and that noncompete agreements between businesses are instead to be evaluated under the "rule of reason" used by federal courts to determine the reasonableness of such agreements under federal antitrust laws.

The Facts

Innovation Ventures produces the well-known 5-hour ENERGY drink. In 2007, Innovation Ventures contracted with Liquid Manufacturing to "produce and package 5-Hour ENERGY at Liquid Manufacturing's bottling plant." When the parties' relationship ended in 2010, they entered into a "Termination Agreement" that contained several noncompete provisions.

In 2012, Innovation Ventures sued Liquid Manufacturing claiming, among other things, that it violated the parties' noncompete agreement by producing competing energy drinks using the same equipment that had previously been used to manufacture 5-hour ENERGY.

The trial court, however, concluded that the noncompete provision was unenforceable because its intent was "to prevent competition, not to prevent an unfair advantage." The court thus held that noncompete was "invalid on its face as an unreasonable restraint of trade."

The Court of Appeals affirmed. The court evaluated the reasonableness of the parties' noncompete provision "under the standard governing noncompete provisions between an employer and employee," concluding that it was "unreasonable, and therefore, unenforceable."

The Supreme Court's Decision

On appeal to the Supreme Court, Innovation Ventures argued that the lower courts "applied the wrong standard to determine whether the noncompete provision was unreasonable." The Supreme Court agreed, holding that "[t]he Court of Appeals erred by applying the standard articulated in MCL 445.774a, which is the proper framework to evaluate the reasonableness of noncompete agreements between employees and employers. Instead, the Court should have applied the rule of reason to evaluate the parties' noncompete agreement."

The Supreme Court observed that while MARA governed the parties' noncompete, the only guidance it provides for "assessing the reasonableness of a noncompete provision" is contained in MCL 445.774a, which "sets forth the factors a court must consider to assess whether a noncompete agreement between an employer and an employee is reasonable." Those factors include whether the agreement is "reasonable as to its duration, geographical area, and the type of employment or line of business," so that it can be said to "protect an employer's reasonable competitive business interests." MCL 445.774a.

The Court concluded that although prior Court of Appeals decisions had applied these factors to commercial noncompetes as well, this was error. The Court reasoned that while the statute does not provide specific guidance as to how courts should evaluate a noncompete agreement between two businesses, it does instruct that courts "should look to federal interpretation of comparable statutes," including the "rule of reason." Citing the United States Supreme Court's decisions in *State Oil Co v Khan*, 522 US 3 (1997), and *Bd of Trade of City of Chicago v United States*, 246 US 231 (1918), the Court explained that "applying the rule of reason, a court must tak[e] into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect." The goal is to determine

"whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts."

Because the lower courts failed to evaluate the noncompete provision in the parties' Termination Agreement under the rule of reason as articulated by federal courts, the Supreme Court remanded the case for further proceedings to determine whether the provision is "reasonable under the rule of reason, and whether Liquid Manufacturing violated the Termination Agreement by producing [competing] energy drinks."

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