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September 2, 2016

From the Desk of Chair Douglas L. Toering

Non-Competes & Adequacy of Consideration in Business Contracts

In a recent decision reversing the Court of Appeals, the Michigan Supreme Court held that non-competes between sophisticated businesses are subject to the rule of reason and that any consideration will generally suffice to support such non-competes/non-disclosure agreements. *Innovation Ventures, LLC v. Liquid Mfg., LLC (/opinions/content_search_detail/EjournalID=86534) et al*, docket no. 150591, 2016 WL 3765943, __Mich __ (July 14, 2016).

In 2007, the plaintiff engaged the K & L defendants (K & L Development of Michigan and Andrew Krause) "to design, manufacture, and install manufacturing and packaging equipment for the production of 5-Hour ENERGY at Liquid Manufacturing's bottling plant." The plaintiff and K & L conducted business pursuant to an oral agreement until 2009. At that time, the plaintiff and K & L executed two written agreements containing various confidentiality and non-compete terms, based on the plaintiff's representation that it "desired to engage [K & L] in designing, manufacturing, and installing additional manufacturing equipment." The new written agreements were terminable at any time upon 14-days written notice and were executed on April 29, 2009. Less than two weeks later, on May 10, 2009, the plaintiff terminated the parties' relationship as permitted by the agreements.

With regard to the LM Defendants (Liquid Manufacturing and Peter Paisley), the plaintiff executed an amended manufacturing agreement with LM on May 18, 2007, whereby LM agreed to manufacture and bottle 5-Hour ENERGY. In June 2010, the plaintiff terminated the parties' relationship, and LM and the plaintiff executed a termination agreement. That document contained various non-disclosure and non-compete provisions. But it did permit LM to produce 36 "Permitted Products" on the equipment that was formerly used to bottle plaintiff's product.

In September 2010, Paisley and Krause founded Eternal Energy, which manufactured a liquid energy shot, "Eternal Energy," that directly competed with 5-Hour ENERGY. Despite Eternal Energy being identified on the list of Permitted Products, the plaintiff filed suit on January 27, 2012, alleging that the defendants had violated the various non-compete and non-disclosure provisions through their manufacture and sale of Eternal Energy. After limited discovery, the trial court granted the defendants' motion for summary disposition and dismissed the plaintiff's claims in their entirety.

With respect to K & L, the Court of Appeals affirmed the trial court's decision, holding that "there was no genuine issue of material fact that the discontinuation of the business/employment relationship within two weeks of the signing of the agreements constituted a failure of consideration" that justified the rescission of the agreement. Thus, the Court of Appeals held that the non-compete and non-disclosure claims against K & L were properly dismissed by the trial court.

With respect to the plaintiff's claims against the LM defendants, the Court of Appeals held that the plaintiff failed to establish a trade secret and, more importantly, had waived the non-disclosure portions of the termination agreement by allowing LM to produce Eternal Energy as a "Permitted Product." With respect to the parties' non-compete agreement, the court held that the provision was overbroad and unreasonable as it sought to prohibit LM from "bottling any energy drink in packaging of four ounces or less without prior approval from plaintiff."

On the plaintiff's appeal to the Michigan Supreme Court, the high court rejected the Court of Appeals' holding that the K & L agreements were void based on a failure of consideration. The Supreme Court stated: "Generally, courts do not inquire into the sufficiency of consideration: [a] cent or a pepper corn, in legal estimation, would constitute a valuable consideration." Furthermore, the Court noted, "failure of consideration does not void a contract when the party seeks to void the contract based on an event explicitly anticipated in the contract" such as, in this case, the termination of the parties' contract at any time.

With respect to LM, the Supreme Court reversed the Court of Appeals' analysis of the non-compete provision, which drew on principles of employment law. The high court held that the proper inquiry was whether the non-compete provisions constituted unreasonable restraints on trade pursuant to antitrust principles and the "rule of reason." Such inquiry, the Court explained, requires the trial court to determine whether the restraint "merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." The Supreme Court therefore remanded the case to the trial court to determine whether the non-compete agreements were valid under the rule of reason, and whether either of the parties had violated the non-disclosure agreements.

In light of the Supreme Court's decision, attorneys representing commercial clients in contract negotiations should carefully consider whether the contractual language adequately ensures that the parties are obligated to carry out the intent of the agreement. Further, counsel should be mindful that a non-compete agreement between businesses will likely be enforced, except in cases where it is obviously disproportionate to the interests it seeks to protect.

I would like to thank Alex Blum for this month's e-newsletter.

If the subject of non-competes and small businesses is of interest to you, perhaps you may wish to become involved in the Small Business Forum. If so, please contact SBF Chair Bruce W. Haffey.

Douglas L. Toering
dtoering@manteselaw.com (mailto:dtoering@manteselaw.com)
(248) 457-9200

Section Events

Cocktail Reception (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=108d426b-d248-4d47-9a40-3c9cd732e23a&Home=/businesslaw/events/recentcommunityeventsdashboard)
September 29; Southfield

Business Law Institute, Annual Meeting, & Award Presentation (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=1c6813c5-ba61-4411-81f0-0462895b1fa3&Home=/businesslaw/events/recentcommunityeventsdashboard)
October 7; Grand Rapids

Regulation of Securities Committee Meeting (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=a44a6906-067d-40c9-9b75-f9f92b7ec700&Home=/businesslaw/events/recentcommunityeventsdashboard)
October 11; Southfield

Midwest Securities Law Institute (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=54f79660-8bad-4dd6-8c98-ed6d83465cbb&Home=/businesslaw/events/recentcommunityeventsdashboard)
October 21; East Lansing

Business Boot Camp 1—West Michigan (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=5010c051-6df1-4d48-9185-79bdb6f01f26&Home=/businesslaw/events/recentcommunityeventsdashboard)
November 3–4; Grand Rapids

Debtor-Creditor Rights Committee Meeting (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=364082a8-7866-4633-bde2-0d43a2995e08&Home=/businesslaw/events/recentcommunityeventsdashboard)
November 16; Southfield

Council Meeting (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=6d644896-2f7c-47a1-ad7b-ef4a45c93496&Home=/businesslaw/events/recentcommunityeventsdashboard)
December 3; Southfield

Business Boot Camp 1—Metro Detroit (http://connect.michbar.org/businesslaw/events/eventdescription?CalendarEventKey=aa70b016-f3be-4372-bdb5-f95cc3c78eea&Home=%2fbusinesslaw%2fevents%2frecentcommunityeventsdashboard)
January 30–31; Plymouth