BUTZEL LONG

Client Alert: Trade Secret and Non-Compete

www.butzel.com

July 27, 2011

Time to Review your Employment Agreements: "Expired" is not the same as "Terminated" when it comes to enforcing restrictive covenants.

Employment agreements that contain both restrictive covenants and specific lengths or terms might pose enforcement risks if the contract simply runs its course and "expires". That's the conclusion of the Michigan Court of Appeals in the recent unpublished decision in VHC, P.C. v. Elshaarawy, M.D., Docket No. 297625 (Mich. App. June 16, 2011).

VHC, P.C. v. Elshaarawy, M.D., involved a situation where Dr. Elshaarawy was hired by VHC, P.C. for a term of one year. The contract provided that employment would "begin on July 01, 2008, and continue for a period of one (1) year(s) or until terminated under the provisions of this Agreement." The agreement also included restrictive provisions that were aimed to preclude the doctor's competition for patients and business after "termination."

After one year, the employment agreement expired according to its terms and no extension was signd by the parties. Dr. Elshaarawy left VHC and began performing vascular services to patients at his new employer. VHC brought suit alleging that Dr. Elshaarawy violated the restrictive covenants by soliciting VHC's patients and contacting VHC's referral physicians. However, both the trial court and the appellate court found that there was no breach of contract because the contract simply expired when its term ended and it was not "terminated." Absent "termination," both courts held, the post-termination restrictions did not take effect.

The restrictive covenants in the employment agreement provided that the physician could not compete with his employer for twenty-four (24) months "following the effective date of termination of employment." [Emphasis Added]. The parties had also agreed that "termination of the employment relationship would not extinguish any obligations created hereunder" and that "[t]he [restrictive] obligations . . . shall survive termination of this Agreement." [Emphasis Added].

Notwithstanding this language, the trial court found that the restrictive covenant was triggered only by a "separation from employment." There was no "separation" because Dr. Elshaarawy's contract simply ended. The Court of Appeals agreed with the trial court. The appeals court noted that the non-compete provision, which was found in the termination section of the contract, addressed termination during the term of the contract. The Court of Appeals found that since there was no termination of employment, these provisions were not applicable.

This is not the first time a court in Michigan has come to that conclusion when addressing this issue. In Stahl v UP Digestive Disease Assoc, PC, Docket No. 276882 (Mich. App. March 24, 2009), the employer notified the physician before expiration of the two-year employment contract (which contained a non-compete provision) that he would not be offered partnership, but could remain employed as an associate. The physician rejected the offer and the contract expired. He joined the staff of a hospital in the area. The physician sued to declare the restrictive provisions unenforceable and the former employer counter sued, seeking enforcement.

Both the lower court and the appellate court found that the contract terms clearly and unambiguously contemplated that the non-compete covenant would become effective only if plaintiff separated from employment during the term of the contract. Because the physician did not separate from his employment but that, rather, his employment ended when the

contract's term expired, the non-compete covenant never took effect.

Adding a lack of clarity to this issue, the Michigan Court of Appeals in 2010 reached an apparently contrary result in Cumulus Broadcasting LLC v. Keady, 2010 WL 1727392 (Mich. App. 2010). In Cumulus, the appellate court reversed the lower court's dismissal of the former employer's attempt to enforce the restrictive covenants, holding that the non-compete provision (which provided that the employee would not compete with his former employer for a period of six months following employment with the company) did survive expiration of the agreement where the employees stayed for six months beyond expiration of the original contract term and continued to work for the employer.

Time to Review Your Employment Agreements

These cases show why employers should review their employment agreements which contain specific lengths or terms to ensure that post-employment restrictive covenants will survive if an employee leaves by other than "termination." Having general survivability clauses in the contract might not do the job. Employers need to clarify what is meant by key terms such as "termination," "resignation," and "expiration." Taking the time now to review your employment contracts might increase the likelihood that they are enforced by a court later.

If you have any questions, please contact the authors of this alert, your Butzel Long attorney or any member of the Butzel Long Trade Secret and Non-Compete Group listed below.

Rebecca S. Davies
313.225.7028
davies@butzel.com

Phillip C. Korovesis
313.983.7458
korovesis@butzel.com

Carey A. DeWitt
313.225.7056
dewitt@butzel.com

Bernard J. Fuhs
313.228.7044
fuhs@butzel.com

Katherine Donohue Goudie
313.225.7027
goudie@butzel.com