Seventh Circuit Finds Five-Year Sale-of-Business Noncompete Agreement Valid

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In *E.T. Products, LLC v. D.E. Miller Holdings, Inc.*, the Seventh Circuit Court of Appeals recently held that noncompete agreements signed by sellers of a business were enforceable under Indiana law, but the sellers did not violate the agreements. In doing so, the court provided valuable considerations for drafting valid noncompete agreements in the context of a sale of business.

**Background**

Doug Miller owned two companies, E.T. Products and Petroleum Solutions, in Bremen, Indiana. E.T. Products blended and sold fuel-additive products. Petroleum Solutions blended and sold lubricant products and supplied E.T. Products fuel additives to a few customers.

In January of 2011, Miller sold E.T. Products to a group of investors. As part of the deal, Doug and his son, Tracy, signed noncompete agreements that for five years prohibited them from “assisting anyone involved in any company either directly or indirectly engaged in the same industry as E.T. Products anywhere in North America.” The Millers also could not “directly or indirectly own, operate, invest in, advise, render services for, or otherwise assist any such competitor.”

A year later, in January of 2012, Miller sold Petroleum Solutions to John Kuhns. Miller provided Kuhns with low-interest financing, a lease on the land on which the business operated, training in lubricant blending, and consulting help. In addition, Tracy provided training on the company’s computer programs for a few months after the sale.

After the sale to Kuhns, Petroleum Solutions continued to be E.T. Products’s supplier and purchased E.T. Products fuel additives for resale. In December of 2012, however, an employee dispute arose and Petroleum Solutions found a new supplier and began blending its own products. When Miller learned that E.T. Products severed its relationship with Petroleum Solutions, he informed Kuhns that he could no longer assist Petroleum Solutions with the additives business due to his noncompete agreement with E.T. Products. Miller’s lease of the business property to Kuhns and Petroleum Solutions continued uninterrupted.

Shortly after, E.T Products sued the Millers in federal court in Indiana alleging breach of their noncompete agreements. Ruling on cross-motions for summary judgment, the district court held in favor of the Millers. E.T Products then appealed to the Seventh Circuit.

**The Seventh Circuit’s Decision**

On appeal, the Seventh Circuit identified two key issues: (1) were the noncompete agreements enforceable, and (2) did the Millers violate the noncompete agreements?

*The Enforceability of the Millers’ Noncompete Agreements*
To start, the Seventh Circuit noted that Indiana courts “generally disfavor noncompete restrictions and enforce them only if they are reasonable.” It also expressed, however, that business-sale noncompete agreements, where the parties have relatively equal bargaining power, “stand in better stead” and “are enforced on a more liberal basis” as compared to noncompete provisions in employment contracts.

Following Indiana law, the Seventh Circuit found that the competition restrictions in the Millers’ noncompete agreements, which prevented them from assisting a competitor “directly or indirectly,” were enforceable under Indiana case law.

The court, however, said the geographic restraint, which spanned all of North America, required a “closer look.” The court focused on whether the noncompete restrictions were broader than necessary to protect E.T. Products’s interests and noted that Indiana courts consider multiple factors in analyzing that question: “(1) the type of business sold, (2) the effect of including territory into which the transferring business did not extend, (3) the extent of the purchaser’s original business as a factor, and (4) the period of restraint.”

In finding that the geographic constraint was reasonable, the court reasoned that (1) a broader geographic restriction may be necessary for a manufacturer or distributor of goods, like E.T Products, where the business “can be expected to reach customers over a larger map,” as opposed to a service business that is normally localized; (2) the Millers could fairly anticipate that E.T. Products would expand throughout North America (and, indeed, it did expand across the continent within two years to all 50 states and 7 Canadian provinces); (3) the scope of E.T. Products corresponded to significant goodwill since Miller spent decades building his reputation and customer relationships and grew the company into 13 states; and (4) the Indiana Supreme Court has previously upheld a 5-year time period as reasonable. Thus, the court found the geographic restrictions were reasonable.

**Whether the Millers Breached Their Noncompete Agreements**

E.T. Products argued that the Millers violated the noncompete agreements by assisting Petroleum Solutions, which E.T. Products claimed was a prohibited form of “indirect” involvement in E.T. Products’s blended and fuel-additives industry. They also contended that the Millers violated the noncompete agreement by failing to break the lease with Petroleum Solutions when Petroleum Solutions found another supplier.

In contrast, the Millers maintained that from January of 2012 until E.T. Products and Petroleum Solutions split in December of 2012, Petroleum Solutions served only as a distributor of E.T. Products, not as its competitor. In addition, when Miller learned the relationship between E.T Products and Petroleum Solutions severed, he informed Petroleum Solutions that he and his son could no longer assist Petroleum Solutions due to the noncompete agreement with E.T. Products.

In rejecting E.T. Products’s argument that the Millers’ assistance to Petroleum Solutions—even when it was only a distributor—still violated the noncompete agreements, the Seventh Circuit stated, “[t]hat’s a bit much. We’re talking about a noncompete agreement after all. Staying true to its name, it was written with the express purpose of preventing the Millers from using their knowledge or relationships ‘to compete with’ E.T. Products.” A company’s distributor is not its competitor.

The court also explained that once the two companies split and Petroleum Solutions found its own supplier and started distributing and blending its own additives, there was no question that Petroleum Solutions became E.T. Products’s competitor. But, by the time the two companies became competitors, the Millers had already ceased helping Petroleum Solutions.

E.T. Products then argued that Miller’s failure to revoke the business lease with Petroleum Solutions violated the noncompete. But the Seventh Circuit said applying a noncompete to that type of action would lead to “absurd results.” Contrasting the case to one in which a company takes affirmative steps to lease to a competitor, the court concluded that “[c]ollecting rent payments on a preexisting lease isn’t the kind of assistance that the noncompete covers.” As a result, the court refused to find that Miller’s failure to break the lease violated the noncompete agreement.

**Conclusion**

In *E.T. Products*, the Seventh Circuit reaffirmed that the purpose of a business-sale noncompete agreement is to prevent a seller from using the seller’s knowledge or relationships to compete with the buyer after the sale. Considering that purpose, the court found that the business-sale agreements and the five-year noncompetition period between the Millers and E.T. Products were reasonable under Indiana law. But, as *E.T. Products* demonstrates, a party enforcing a noncompete does not prevail merely by showing the agreement was reasonable. It must also prove the agreement was violated. In this case, it was not.