ILLINOIS BAR JOURNAL

April 2012

100 Years ■ Vol. 100, No. 4 ■ www.isba.org/ibj

The Magazine of Illinois Lawyers

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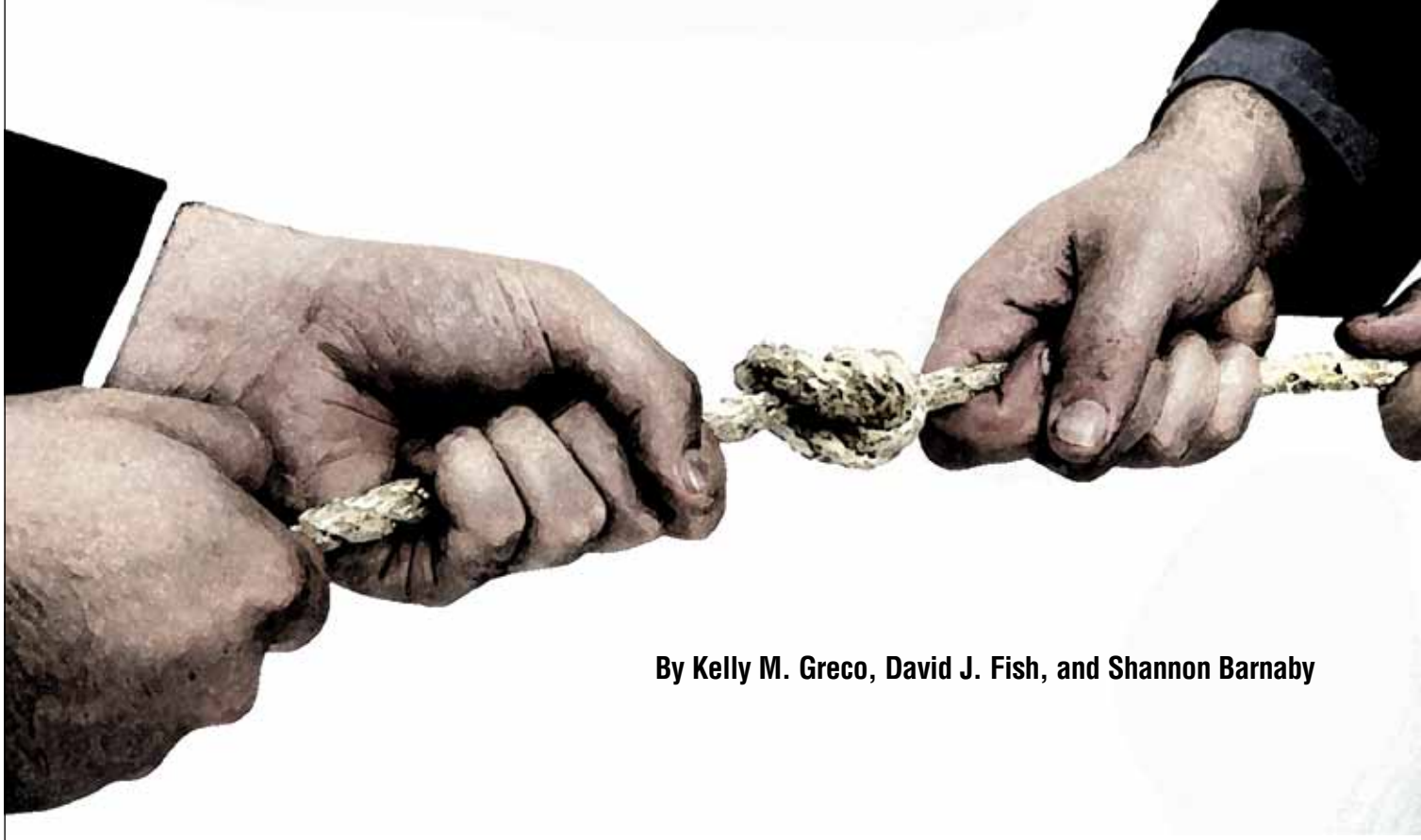

By Kelly M. Greco, David J. Fish, and Shannon Barnaby

For more than 30 years, Illinois courts applied the legitimate-business-interest test when analyzing whether a restrictive covenant in an employment agreement is valid.[1] Then, in 2009, the appellate fourth district in *Sunbelt Rentals, Inc. v Ehlers* held the legitimate-business-interest test invalid, stating it had no basis in Illinois precedent and was created "out of whole cloth."[2]

Sunbelt created a question in the Illinois Appellate Court about whether the test was valid.[3] In *Reliable Fire Equipment Company v Arredondo*, the Illinois Supreme Court rejected the fourth district holding and found the legitimate-business-interest test valid.[4]

But the *Reliable Fire* court went further. The justices refashioned the legitimate-business interest analysis, holding that the decades-old two-part test should no longer be used as the sole measure for deciding whether a business interest is legitimate. Instead, the court incorporated that test as merely one "nonconclusive" component to be used in conjunction with a three-prong analysis that will give judges in restrictive-covenant broad discretion to base their rulings on the facts of the case.[5]

This article begins with background on the law of covenants not to compete in employment contracts. It then discusses the fourth district's *Sunbelt* decision and the supreme court's *Reliable Fire* ruling. Finally, it looks at what the new standard means for employers and employees.

Overview of restrictive covenants

Many employers use restrictive covenants in employment contracts in an attempt to control an employee's post-employment actions[6] and thereby protect their goodwill, client relationships, intellectual property, trade secrets, and confidential information.[7] From an employee's standpoint, post-employment restrictive covenants limit economic mobility and freedom.[8] Courts regard post-employment restrictive covenants as a restraint of trade and carefully scrutinize their use.[9]

Emergence of the legitimate-business-interest test. In Illinois, courts traditionally enforced restrictive covenants only if they are supported by adequate consideration, are ancillary to a valid employment contract or relationship, protect a legitimate business interest, and impose reasonable restrictions on the employee's subsequent employment.[10] The first

1. See *Sunbelt Rentals, Inc. v Ehlers*, 394 Ill App 3d 421, 427, 915 NE2d 862, 867 (4th D 2009), citing *Office Mates 5, North Shore, Inc. v Hazen*, 234 Ill App 3d 557, 569, 599 NE2d 1072, 1080 (1st D 1992); *Dam, Snell & Taveirne, Ltd v Verchota*, 324 Ill App 3d 146, 151-152, 754 NE2d 464, 468-469 (2d D 2001); *Lyle R. Jager Agency, Inc. v Steward*, 253 Ill App 3d 631, 636, 625 NE2d 397, 400 (3rd D 1993); *Springfield Rare Coin Galleries, Inc. v Mileham*, 250 Ill App 3d 922, 929, 620 NE2d 479, 485 (4th D 1993); *Carter-Shields v Alton Health Institute*, 317 Ill App 3d 260, 268, 739 NE2d 569, 575 (5th D 2000)
2. *Sunbelt Rentals, Inc.* at 427, 915 NE 2d at 867.
3. Compare with *Steam Sales Corp. v Summers*, 405 Ill App 3d 442, 937 NE2d 715 (2d D 2010).
4. 2011 IL 111871 ¶ 42.
5. Id.
6. John F. Kennedy & Suzanne L. Sias, *Employment Contracts Involving Restrictive Covenants and Trade Secrets*, *in* 3 Bus Law 7-5, Ill Inst For Continuing Legal Educ. (2005).
7. Id at 7-4.
8. *Wessel Co. v Busa*, 28 Ill App 3d 686, 690, 329 NE2d 414, 417 (1st D 1975); *C.G. Caster Co. v Regan*, 43 Ill App 3d 663, 667, 357 NE2d 162, 165 (1st D 1976); *Emery-Drexel Livery v Cook-Du Page Transportation Co.*, 40 Ill App 3d 937, 940, 353 NE2d 182, 184 (1st D 1976).
9. *Wessel Co.* at 690, 329 NE2d at 417; *C.G. Caster Co.* at 667, 357 NE2d at 165.
10. *Lawrence & Allen, Inc. v Cambridge Human Resource Group, Inc.*, 292 Ill App 3d 131, 137, 685 NE2d 434, 440 (2d D 1997).

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This article discusses enforcing restrictive covenants in Illinois following the Illinois Supreme Court's decision late last year in *Reliable Fire Equipment Company v Arredondo*. The authors offer practice tips for lawyers on both sides of a non-compete case.

Enforcing Non-Compete Clauses in Illinois after *Reliable Fire*

district is credited with establishing the legitimate-business-interest test with its 1975 decision in *Nationwide Advertising Services, Inc. v Kolar*.[11]

In that case, an advertising agency sought to enforce a restrictive covenant against its former employee.[12] On interlocutory appeal from an order denying enforcement, the agency argued that "under Illinois law an employer…had a *legitimate business interest* in its customers which was subject to protection through enforcement of an employee's covenant not to compete."[13] Upon reviewing the cases relied on by the agency, the *Kolar* court wrote as follows:

> [A]n employer's business interest in customers is not always subject to protection through enforcement of an employee's covenant not to compete. Such interest is deemed proprietary and protectable only if certain factors are shown. A covenant not to compete will be enforced if [(1)] the employee acquired confidential information through his employment and subsequently attempted to use it for his own benefit. An employer's interest in its customers also is deemed proprietary if, [(2)] by the nature of the business, the customer relationship is near-permanent and but for his association with plaintiff, defendant would never have had contact with the clients in question. Conversely, a protectable interest in customers is not recognized where the customer list is not secret, or where the customer relationship is short-term and no specialized knowledge or trade secrets are involved. Under these circumstances the restrictive covenant is deemed an attempt to prevent competition per se and will not be enforced.[14]

In the decades following *Kolar*, each district of the Illinois Appellate Court applied the legitimate-business-interest test in restrictive covenant cases.[15] A large body of case law developed on each of the two parts of the *Kolar* test, defining in detail when an employee has acquired confidential information[16] and when an employer has near-permanent customer relationships.[17] As is discussed further below, however, the Illinois Supreme Court ruled in *Reliable Fire* that the two-part "confidential information"

11. 28 Ill App 3d 671, 329 NE2d 300 (1st D 1975).
12. Id at 672, 329 NE2d at 301.
13. Id (emphasis added).
14. Id at 673, 329 NE2d at 301-02 (citations omitted).
15. *Sunbelt Rentals, Inc. v Ehlers*, 394 Ill App 3d 421, 427, 915 NE2d 862, 867 (4th D 2009). See *Office Mates 5, N. Shore, Inc. v Hazen*, 234 Ill App 3d 557, 568-69, 599 NE2d 1072, 1080 (1st D 1992); *Dam, Snell & Taveirne, Ltd. v Verchota*, 324 Ill App 3d 146, 151-52, 754 NE2d 464, 468-69 (2d D 2001); *Hanchett Paper Co. v Melchiorre*, 341 Ill App 3d 345, 351, 792 NE2d 395, 400 (2d D 2003); *Springfield Rare Coin Galleries, Inc. v Mileham*, 250 Ill App 3d 922, 930, 620 NE2d 479, 485 (4th D 1993); *Carter-Shields v Alton Health Institute*, 317 Ill App 3d 260, 268, 739 NE2d 569, 575-76 (5th D 2000).
16. A large body of law grew over the years around just the "confidential information" part of the two-part *Kolar* legitimate-business-interest test. For instance, to be "confidential," information must have been developed by the employer "over a number of years at great expense and kept under tight security." A*.J. Dralle, Inc. v Air Tech, Inc.*, 255 Ill App 3d 982, 992, 627 NE2d 690, 697 (2d D 1994). See also *Lifetec, Inc. v Edwards*, 377 Ill App 3d 260, 270, 880 NE2d 188, 196 (4th D 2007). Information is not "confidential" if it has not been treated as such by the employer, was generally available to other employees and known in the trade, or could easily found in telephone directories or industry publications. Customer lists are not confidential when customers did business with more than one company or their identities were known to the employer's competitors. *A.J. Dralle, Inc.*, 255 Ill App 3d at 992, 627 NE2d at 697; *Lifetec, Inc.*, 377 Ill App 3d at 270, 880 NE2d at 196.
17. Illinois courts have developed two tests for evaluating whether an employer has a near-permanent relationship with its customers or clients: the "seven factor" test and the "nature of the business" test. *Outsource Int'l, Inc. v Barton*, 192 F3d 662, 667 (7th Cir 1999) (applying Illinois law). The "seven factors" are (1) the number of years it took the employer to develop the clientele, (2) the amount of money spent and (3) degree of difficulty in doing so, (4) how much personal contact the employee had with customers, (5) how well the employer knew its clientele, (6) how long customers were associated with the employer, and (7) the continuity of the employer-customer relationship. *A.B. Dick Co. v American Pro-Tech*, 159 Ill App 3d 786, 793, 514 NE2d 45, 49 (1st D 1987). See also *McRand, Inc. v van Beelen*, 138 Ill App 3d 1045, 1051-52, 486 NE2d 1306, 1311-12 (1st D 1985). After evaluating these factors, the court asks whether but for the job with the employer the employee would have come into contact with the customers. *McRand, Inc.*, 138 Ill App 3d at 1053, 486 NE2d at 1312. Courts using the "nature of the business" test generally divide business types into two categories: sales, where near-permanent relationships with customers typically do not exist, and professional services, when near-permanent relationships are presumed. See *Lawrence & Allen, Inc. v Cambridge Human Resource Group, Inc.*, 292 Ill App 3d 131, 142, 685 NE2d 434, 444 (2d D 1997). This test recognizes that certain businesses have an easier time proving near-permanence and thus a legitimate business interest in their customers. *Office Mates 5, N. Shore, Inc. v Hazen*, 234 Ill App 3d 557, 571, 599 NE2d 1072, 1081 (1st D 1992). For example, plaintiffs are likely to prevail under the near-permanency test where they are engaged in a professional practice, sell a unique product or service, or are under contracts with customers. Id. The opposite is true for plaintiffs engaged in businesses where customer loyalty is not important and customers use many suppliers simultaneously. Id at 571, 599 NE2d at 1082.

and "near-permanent relationship" test is now merely one aspect, not the sum total, of the legitimate-business-interest test.

Fourth district rejects legitimate-business-interest test in *Sunbelt Rentals*

Sunbelt arose out of a common fact pattern in restrictive covenant cases. In May 2003, Ehlers accepted a sales representative position with Sunbelt Rentals.[18] In June 2003, he signed a written employment agreement that prohibited him from competing with Sunbelt for one year after the termination of the agreement.[19]

In early January 2009, he accepted a sales representative position with Midwest Aerials & Equipment, Inc. in its Bloomington office.[20] Later that month, Ehlers submitted his written resignation and Sunbelt subsequently terminated his employment.[21] They soon discovered that Ehlers had accepted a sales position with Midwest.[22]

In February 2009, Sunbelt sued Ehlers and Midwest seeking preliminary and permanent injunctive relief.[23] Sunbelt claimed that (1) Ehlers violated the restrictive covenants of his employment agreement when he accepted Midwest's offer and (2) Midwest tortiously interfered with Sunbelt's employment agreement with Ehlers.[24] In granting a preliminary injunction, the trial court found that the time-and-territory terms in Sunbelt's employment agreement were reasonable.[25]

On appeal, the fourth district addressed whether the trial court abused its discretion by issuing a preliminary injunction because (1) the court failed to follow controlling precedent and (2) Sunbelt did not have a sufficient legitimate business interest.[26] The appellate court noted the extensive Illinois precedent regarding the legitimate-business-interest test but nevertheless concluded that the Illinois Appellate Court created the test "out of whole cloth."[27]

The fourth district rejected the test "because (1) the Supreme Court of Illinois has never embraced [it] and (2) its application is inconsistent with the supreme court's long history of analysis in restrictive covenant cases...."[28] It offered an alternative approach:[29]

> The lesson of the supreme court's decisions...is that courts at any level, when presented with the issue of whether a restrictive covenant should be enforced, should evaluate only the time-and-territory restrictions contained therein. If the court determines that they are not unreasonable, then the restrictive covenant should be enforced. Thus, this court need not engage in an additional discussion regarding the application of the "legitimate-business-interest" test because that test constitutes nothing more than a judicial gloss incorrectly applied to this area of law by the appellate court.[30]

The court held that the restrictions in Ehlers' contract were reasonable and consistent with supreme court precedent.[31]

Reliable Fire Equipment Company v Arredondo

Second district ruling. The second district addressed the fourth district's rejection of the legitimate-business-interest in *Reliable Fire Equipment Company v Arredondo*.[32] On appeal, the defendants argued that Reliable Fire did not have a protectable interest in its customers and the restrictive covenant in the employment agreement at issue was unreasonable.[33] Noting the fourth district's rejection of the legitimate-business-interest test in *Sunbelt*, the second district set forth an exhaustive history of restrictive covenants in Illinois.[34] Ultimately, the second district disagreed with the fourth district:

> [C]ontrary to the historical evolution of the law of restrictive covenants, [*Sunbelt*] disallows inquiry into whether the employer has an interest other than suppression of ordinary competition...[T]he *Sunbelt* approach, and the approach taken by the dissent, lead to a public policy favoring restraint of trade. Ultimately, we conclude that the legitimate-business-interest test grew out of the centuries-old Anglo-American policy against restraint of trade and that there is no reason to abandon it...Moreover, our research reveals that our supreme court has recognized that a distinct element of the analysis in determining the enforceability of a restrictive covenant is whether the restraint protects a legitimate interest of the promisee. Thus, we come to the conclusion that the legitimate-business-interest test is consistent with principles embraced by our supreme court.[35]

The second district's ruling created a split in the Illinois Appellate Court over whether the legitimate-business-interest test is valid, and *Reliable Fire* went to the Illinois Supreme Court.

Illinois Supreme Court ruling. The supreme court began its analysis in *Reliable Fire*[36] by stating that, while general restraints of trade are void because they injure the public and the individual promisor,[37] a restrictive covenant will be upheld if the restraint is reasonable and supported by consideration.[38]

Reliable Fire lowers the burden employers must meet by expanding the categories of legitimate business interests beyond confidential information or near-permanent customer relationships.

The court then laid out the three-part test for determining when a restrictive covenant is a reasonable restraint in an employment agreement. Such a covenant not to compete is enforceable only if it (1) is no greater than required to protect a legitimate business interest of the employer-promisee, (2) is not an undue hardship on the employee-promisor, and (3) does not injure the public.[39] The court then set forth an exhaustive history of Illinois Supreme Court precedent recognizing this three-prong "rule of reason" requiring the promisee to have a legiti-

18. *Sunbelt Rentals, Inc. v Ehlers*, 394 Ill App 3d 421, 422, 915 NE2d 862, 863 (4th D 2009).
19. Id at 423, 915 NE2d at 863-64.
20. Id at 424, 915 NE2d at 864.
21. Id.
22. Id.
23. Id at 425, 915 NE2d at 865.
24 Id.
25. Id.
26. Id at 422, 915 NE2d at 863.
27. Id at 427, 915 NE2d at 867.
28. Id at 431, 915 NE2d at 870.
29. Id at 431, 915 NE2d at 869.
30. Id.
31. Id at 432-33, 915 NE2d at 871.
32. 405 Ill App 3d 708, 940 NE2d 153 (2d D 2010).
33. Id at 720, 940 NE2d at 162.
34. Id at 723-37, 940 NE2d at 165-75.
35. Id at 723, 940 NE2d at 165.
36. *Reliable Fire Equip Co. v Arrendondo*, 2011 IL 111871
37. Id at ¶ 16.
38. Id (citing *Storer v Brock*, 351 Ill 643, 647, 184 NE2d 868 (1933)
39. Id at ¶ 17 (citing Restatement (Second) of Contracts § 187 cmt b, § 188(1) & cmts a, b, c (1981)).

mate business interest.[40]

Based on this analysis, the supreme court expressly rejected the fourth district's holding in *Sunbelt*.[41] The supreme court concluded that the legitimate-business-interest test is still viable as part of the three-part test to determine the enforceability of a restrictive covenant not to compete.[42]

In articulating the three-part test, the court also rejected the long-established two-factor test espoused by the Illinois Appellate Court in *Kolar*, in which the existence of a near-permanent customer relationship (e.g., a professional practice) and the employee's acquisition of confidential information through his employment means that the employer's business interest is legitimate and protectable.[43]

Thus, whether a legitimate business interest exists is now based on the totality of the facts and circumstances of each case, not on the two-part *Kolar* test.[44] Factors to be considered include, but are not limited to, the near-permanence of customer relationships, the employee's acquisition of confidential information through his employment, and time and place restrictions.[45] No single factor carries any more weight than any other in the abstract, the court observed. Its importance will depend on the facts of the case.[46]

Judges might be more likely to allow a non-compete dispute to proceed to discovery because of the supreme court's mandate to look at the totality of the circumstances.

How does *Reliable Fire* affect practitioners?

The supreme court's decision in *Reliable Fire* promotes good public policy by ensuring that courts analyzing restrictive covenants look at the interests the promisee is trying to protect. In this way, courts can continue to limit the scope of employers' restrictive covenants and protect employees' economic mobility and freedom. However, the decision also lowers the burden employers must meet by expanding the categories of legitimate business interests to more than simply confidential information or near-permanent customer relationships.

The Illinois Supreme Court made clear that these categories are no longer determinative and are merely factors to be considered. Thus, employers will be able to argue broader categories of protectable interests.

From a practical standpoint, judges may now be less likely to grant a motion to dismiss. Instead, they might allow a non-compete dispute to proceed to discovery because of the supreme court's mandate that courts look at the totality of the circumstances of each case. In a dispute between a well-funded employer and an employee with limited resources, the prospect of protracted litigation could give the employer the upper hand.

Likewise, by abandoning the rigid formula that had developed, the court created opportunities for employers to argue other types of "legitimate business interests" that support enforcing a non-compete. On the other hand, employers must be ready to demonstrate that their non-compete agreements are reasonable and tailored to the business interest they seek to protect.

Here are points to consider when representing either side in non-compete disputes.

Representing employees

Look for employer misbehavior. Let the employer know in detail about any alleged misconduct on its part that may give rise to an unclean hands defense, as well as any claim that it violated the covenant of good faith and fair dealing or that it materially breached the agree-

(Continued on page 219)

40. Id at ¶¶ 18-24 ("This discussion shows that this court … has repeatedly recognized the three-dimensional rule of reason, specifically including the element of the legitimate business interest of the promisee.").
41. Id at ¶ 27.
42. Id at ¶ 43.
43. Id.
44. Id.
45. Id.
46. Id.

A sane approach to billable hours

A divorce lawyer friend of mine was financially ambitious. He established a policy for himself of staying at the office until he billed 12 hours for the day.

I want lawyers in my firm to produce good billable hours, but I also want them to have a good life outside of the practice. My firm does have a minimal weekly billable hour goal for all lawyers, but it is a reasonable one. My firm does not have sleeping cots for overtime lawyers. ■

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ment. Employers sometimes engage in unethical and/or illegal conduct.

For example, was your client forced to leave because the employer overbilled customers, violated safety rules, or would not pay your client? Detailing this misconduct early may give the employer second thoughts about airing dirty laundry in a public courtroom.

Read the contract. Does the non-compete really prohibit your client's conduct? Many form non-compete agreements are written poorly and by their plain language do not apply to certain situations, and judges often narrowly construe restrictive covenants. Is your client's conduct even covered by the non-compete?

Is the agreement overbroad? Is the non-compete overly broad? Some are prohibitive to the point of being unenforceable. A judge will not necessarily rewrite/blue pencil the agreement to make it enforceable.

Was there consideration? Was there sufficient consideration for the restrictive covenant? Case law addresses whether continued employment is sufficient consideration when the employee is not employed for a lengthy period.

Do a cost/benefit analysis. Properly advise your client that being right can be expensive. Many employees seem to believe that Illinois courts rarely if ever enforce non-compete agreements. This has never been the law and certainly is not after *Reliable Fire*. Even if a client prevails, the cost of challenging a non-compete agreement may exceed the cost of waiting out the restricted period.

Representing employers

Pigs are slaughtered. Employers sometimes want to impose broad restrictions while providing no consideration in exchange for them. The risk is that a court may find the agreement unenforceable and refuse to use a blue pencil to narrow it. Make sure it is no more restrictive than necessary to meet legitimate business goals and is supported by adequate consideration.

Thou shalt not steal. Did the employee take anything that did not belong to her when she left? Many do, and when this happens the non-compete might be the icing on the cake in a much stronger case.

Conduct a forensic examination of the employee's computer/smartphone. Many employees download, email to themselves, or print proprietary information before leaving. When a judge sees the intentional misappropriation of an employer's confidential property, preliminary injunctive relief is more likely.

Present detailed evidence. Track the case law and provide specific facts about why a court should enforce your non-compete agreement. For example, show how the employer's confidential information will inevitably be disclosed to a competitor and why it is so important to protect the employer.

Include attorney fees. Include an attorney fee provision in non-compete agreements. An employee faced with the possibility of paying tens of thousands of dollars in attorney fees for violating a contractual provision will think twice before acting.

Consider third-party claims. Consider claims against third parties, such as the competitor that hired your client's former employee. A competitor who induced your employee to breach a non-compete agreement could be benefiting from, e.g., the disclosure of trade secrets. The competitor might appear to be unlawfully raiding your client's company, which would be the basis of a claim. ■