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Drafting enforceable non-competition agreements in Illinois

By Peter A. Steinmeyer and Jake Schmidt¹

In an effort to protect their human capital, employers nationwide are increasingly requiring employees to sign post-employment non-competition agreements, even though many states, such as Illinois, are generally hostile to such agreements. With proper forethought, however, even Illinois employers can craft enforceable non-competition agreements which meet their needs, if not their wants.

Non-competition agreements stem from a variety of motives. Some of these are recognized by Illinois courts as legitimate (e.g., the protection of trade secrets and "near permanent" client relationships), while others are not (e.g., a desire to stifle competition). Although a desire to stifle competition is certainly understandable from a human perspective, a non-competition agreement which goes too far may be deemed totally unenforceable by a court—even if there is a contractual clause authorizing a court to modify the agreement as needed to render it enforceable. Accordingly, the preparation of any non-competition agreement should begin with a realistic assessment of what restrictions are likely to be enforced by a court, and what protections are really needed.

For purposes of a non-competition agreement, what is a legitimate, protectible interest under Illinois law?

As a starting point, under Illinois law, there are two general situations in which an employer will be found to have a legitimate, protectible interest sufficient to justify a post-employment covenant not to compete—near permanent customer relationships and trade secrets/confidential information:

Where, by the nature of the business, an employer has a near-permanent relationship with its customers and, but for his associa-

tion with his employer, an employee would have had no contact with them; or where the former employee learns trade secrets or acquires other confidential information during his employment and subsequently attempts to use it for his own benefit.

Arpac Corp. v. Murray et al., 226 Ill. App.3d 65, 72-73, 589 N.E.2d 640, 647 (Ill. App. 1 Dist. 1992).

Illinois courts apply one of two alternative tests when determining whether an employer has a "near permanent relationship" with its customers. Some courts apply a "nature of the business" test, while others apply a seven-factor, objective test. *Lawrence and Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 292 Ill.App.3d 131, 685 N.E.2d 434, 443 (Ill. App. 2 Dist 1997).

Under the "nature of the business test," a court will look to the nature of the employer's business to determine whether its client relationships are near permanent. *Id.* A near permanent relationship with clients is deemed "inherent in the provision of professional services." *Id.* In contrast, "a near permanent relationship is generally absent where the nature of the plaintiff's business does not engender customer loyalty by providing a unique product or personal service and customers utilize many suppliers simultaneously to meet their needs." *Id.* Thus, "a near permanent relationship with customers is generally absent from businesses engaged in sales." *Id.*

Meanwhile, the objective seven-factor test for "near permanent customer relationships" has been summarized as follows:

To determine whether an employer has a near-permanent relationship with its customers, Illinois courts consider the following factors: (1) the

length of time required to develop the clientele; (2) the amount of money invested to acquire clients; (3) the degree of difficulty in acquiring clients; (4) the extent of personal customer contact by the employee; (5) the extent of the employer's knowledge of its clients; (6) the duration of the customer's association with the employer; and (7) the continuity of the employer-customer relationship.

Hanchett Paper Co. v. Melchiorre, 341 Ill. App.3d 345, 792 N.E.2d 395, 401 (Ill. App. 2 Dist. 2003) (internal quotation marks and citation omitted).

Due to the practical difficulty of establishing "near permanent customer relationships," in most circumstances, an employer seeking to enforce a post-employment, non-competition agreement will need to establish that its former employee learned trade secrets or acquired other confidential information during his employment and subsequently attempted to use it for his own benefit.

Has any Illinois court rejected the legitimate business interest test?

In September 2009, the Fourth District Court of Appeal in *Sunbelt Rentals, Inc. v. Ehlers*, 333 Ill.Dec. 791, 915 N.E.2d 862 (Ill. App. Ct. Sept. 23, 2009), rejected the "legitimate business interest" test, reasoning that the test was not supported by any decision of the Illinois Supreme Court. According to the *Sunbelt* court, a trial court addressing the enforceability of a non-competition agreement should evaluate only the time-and-territory restrictions contained therein. This decision is contrary to decisions from every other appellate court in Illinois (including prior decisions of the Fourth District Court of Appeal).

As of the date of this article, only one published decision, *Aspen Marketing Services, Inc. v. Russell*, No. 09 C 2864, 2009 WL 4674061 (N.D. Ill. Dec. 3, 2009), has cited *Sunbelt*. In that case, federal district court judge Robert Gettleman noted his awareness of *Sunbelt* and its rejection of the legitimate business interest test, but he applied the test anyway, noting that “[t]he Illinois Supreme Court, the United States Court of Appeals for the Seventh Circuit, and this court, however, have not rejected the application of the legitimate business interest test.” Judge Gettleman did not otherwise elaborate on his decision to apply the legitimate business interest test.

Although the *Sunbelt* decision has injected uncertainty into this area, it is important to note that the Fourth District Court of Appeal covers only the counties in the middle of the State. Neither the Illinois Supreme Court nor any other Illinois appellate court (including those courts of appeal covering the Chicago area) have rejected the legitimate business interest test. Similarly, no federal court located in Illinois has rejected the legitimate business interest test.

Can an employer take steps to bolster its claim that it has a protectible interest?

Whether an employer has a protectible interest is a factual inquiry. However, when drafting a non-competition agreement, it is advisable to include representations regarding the interest that the agreement is intended to protect (e.g., an acknowledgement by the employee that by virtue of his employment with the employer, he has obtained, or will obtain, access to confidential information and/or trade secrets of the employer, in addition to special knowledge and familiarity with the needs and requirements of the employer’s customers). See e.g., *Arpac Corp.*, 589 N.E.2d at 650.

Assuming that an employer can establish the existence of a protectible interest, what practical steps can it take to bolster the enforceability of a non-competition agreement?

Under Illinois law, once a protectible interest is established, irreparable injury for purposes of injunctive relief “is presumed to follow if the interest is not protected.” *McRand, Inc. v. Van Beelen*, 138 Ill. App.3d 1045, 486 N.E.2d 1306, 1313 (Ill. App. 1 Dist. 1985). Indeed, the mere fact of ongoing competition is a sufficient basis for injunctive relief, and it is not necessary to prove “any customer defection and monetary loss.” *Armour and Company v. United American Food Processors*, 37

Ill. App.3d 132, 345 N.E.2d 795, 799 (Ill. App. 1 Dist. 1976).

Nevertheless, when deciding whether to issue injunctive relief, a court will also look to see whether the restriction on competition is “reasonable”—an inquiry that will entail examination of the “hardship to the employee, its effect upon the general public, and the reasonableness of the time, territory, and activity restrictions.” *Lawrence and Allen*, 685 N.E.2d at 441.

There are several practical steps that counsel can take to improve the odds that a court will enforce a non-competition agreement.

First, recognizing that Illinois law is, in the words of Seventh Circuit Judge Richard A. Posner, “hostile to covenants not to compete found in employment contracts,” *Outsource International, Inc. v. George Barton and Barton’s Staffing Solutions*, 192 F.3d 662, 669 (7th Cir. 1999), thought should be given to a choice of law provision specifying the law of a state other than Illinois. While there is a risk that an Illinois court would not enforce such a provision, if there is a legitimate relationship between the parties and the designated state (e.g., where the employer maintains its headquarters in the designated state), such a choice of law provision merits consideration.

Second, any restriction on a former employee’s activities should be no broader in scope than absolutely necessary. If an employer does not do business in Alaska, it should not prohibit a former employee from working there. Likewise, “Courts are hesitant to enforce prohibitions against employees servicing not only customers with whom they had direct contact, but also customers they never solicited or had contact with.” *Lawrence and Allen*, 685 N.E.2d at 441. See also, *Morrison Metalweld Process Corporation v. Frank J. Valent*, *Morrison Metalweld Process Corporation v. Frank J. Valent*, 97 Ill. App.3d 373, 379-380, 422 N.E.2d 1034, 1039, 52 Ill. Dec. 825 (Ill. App. 1 Dist. 1981) (enforcing two-year restriction barring defendant from doing business with the specific customers with whom he came in contact while employed by plaintiff, regardless of their geographic location); and *McRand*, 486 N.E.2d at 1315-1316 (holding that “no undue hardship will be suffered by defendants” because they “are only restricted from selling to certain McRand customers”; “the rest of the field remains open to them for competition with McRand”).

Third, employers should be realistic about the duration of the agreement. One year will most likely pass muster; three years may not.

Moreover, a shorter duration can be coupled with a tolling provision (providing that the restricted period will not run during any period of violation) to meet the employer’s needs.

Fourth, because a covenant not to solicit customers will be subject to lesser judicial scrutiny than a covenant not to work for any competitor, employers should consider separate “non-solicitation” and “non-competition” clauses with different durations (e.g., a 12-month customer solicitation ban, but only a six-month ban on working for a competitor). *Lawrence and Allen*, 685 N.E.2d at 442.

Fifth, every non-competition agreement should include a severability clause providing that the invalidity of one provision shall not affect the validity of any other provision.

Finally, every non-competition agreement should include a “blue pencil” provision authorizing and requesting any reviewing court to revise an otherwise overbroad restriction to include the maximum restriction allowed under applicable law. Such “blue pencil” provisions are enforceable under Illinois law, unless the original agreement was so unreasonable as to be unfair. *Eichmann v. National Hospital and Health Care Services, Inc.*, 308 Ill. App.3d 337, 347, 719 N.E.2d 1141, 1149 (Ill. App. 1 Dist. 1999); *Kempner Mobile Electronics v. Southwestern Bell*, No. 02 C 5403, 2003 WL 1057929 at *19 (N.D. Ill. March 7, 2003). For purposes of this analysis, “[a] restrictive covenant is unfair where its terms ‘clearly extend far beyond those necessary to the protection of any legitimate interest’ of the employer or, in other words, amount to ‘unrealistic boundaries in time and space.’” *Eichmann*, 719 N.E.2d at 1149, quoting *House of Vision, Inc. v. Hiyon*, 37 Ill.2d 32, 225 N.E.2d 21, 25 (Ill. S.Ct. 1967). (This is yet another reason to narrowly draft a non-competition agreement at the outset!).

Are there other provisions that should be included in a non-competition agreement?

Although Illinois law is somewhat hostile to non-competition agreements, it is very protective of an employer’s trade secrets and confidential information—situations which are viewed no differently than other situations involving theft of employer property. See, Illinois Trade Secrets Act, 765 ILCS 1065/1 et seq. Accordingly, every non-competition agreement should also include a provision requiring the return, at termination, of all employer property and information (in any and all forms, including electronically stored

information), and a permanent prohibition on the usage or disclosure of employer trade secrets or other confidential information, as defined in the agreement.²

Similarly, Illinois employers have a protectible interest in maintaining a stable workforce which is sufficient to justify restrictions on a former employee's ability to recruit former co-workers. *Arpac*, 589 N.E.2d at 649. Accordingly, every non-competition agreement also should include an "anti-raiding" clause with a time duration consistent with that of the underlying non-competition provisions.

Is an overbroad non-competition agreement nevertheless justified by added deterrent effect?

One school of thought with respect to non-competition agreements is that even though a broadly drafted agreement is unlikely to be enforced, it will still have deterrent value in terms of making current employees (and their future employers) think twice before engaging in actions that would violate the agreement. There is undoubtedly some merit to this view. However, if an employer thinks that it may actually want to enforce a non-competition agreement, it should err on the side of narrow drafting.

Is there any legislation pending in Illinois related to non-compete agreements?

A bill entitled the "Illinois Covenants Not To Compete Act" was recently introduced in the Illinois House of Representatives. If enacted into law, this bill would significantly limit the enforceability of no-competes and make them easier for individuals to challenge. However, in certain respects, the bill would also make no-competes easier to enforce.

In pertinent part, the bill would limit the enforceability of no-competes by providing as follows:

- No-competes would be unenforceable against everyone other than a "key employee" or "key independent contractor" (categories which are actually fairly broadly defined in the bill);
- Mere continued employment would no

longer be adequate consideration to support a no-compete; rather, the employer would have to provide "a material advancement or promotion" or "a material bonus or material increase" in salary; and

- There would be rebuttable presumptions that: any restriction exceeding one year is unenforceable; any geographic restriction that extends beyond the region in which the individual provided services is unenforceable; and any restriction on an individual's ability to perform services other than services of the same type performed for that employer is unenforceable.

The bill would also make it far easier for an individual to challenge a no-compete, because it provides that any individual can bring a declaratory judgment action to challenge the enforceability of his/her no-compete and if the challenge is successful, the employer would have to pay his/her legal fees (but if the individual loses, they would not have to pay the employer's fees).

In a related vein, the bill would make it riskier for many employers to try to enforce no-competes, because it provides that any "one way" fee shifting provision in a no-compete (i.e., a clause providing that if an employer has to incur attorney's fees to enforce the agreement, the individual must pay the employer's fees) shall be construed to provide for "two way" fee shifting (i.e., loser pays, regardless of which side loses).

Notwithstanding the foregoing provisions, in certain respects the bill would actually make no-competes more enforceable because it would make it far easier to establish the existence of a legitimate business interest sufficient to justify a no-compete (a high threshold to clear under current Illinois law) and because it expands the ability of judges to modify restrictions in a no-compete to make them enforceable.

Additionally, the proposed law contains a number of broad exceptions. Specifically, it would not apply to anti-raiding provisions (which bar former employees from recruiting their former colleagues); anti-solicitation

clauses (which bar customer solicitations); confidentiality agreements (which protect confidential information); "employee choice" clauses in incentive compensation programs (which require the forfeiture of incentive compensation in the event an individual engages in prohibited conduct); and agreements between corporations, partnerships, limited liability corporations or partnerships, and their shareholders, partners, and members.

Conclusion

The bottom-line in Illinois is that no matter how carefully a non-competition agreement is drafted, there is no guarantee of enforceability—even with a blue-pencil provision. However, by focusing on the protections an employer needs, as opposed to those it merely wants, an employer can significantly improve the odds that its non-competition agreement will actually stand up in court.³ ■

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2. The need to protect trade secrets may also allow an employer to seek an injunction barring a former employee from working in certain positions in which he would inevitably use or disclose the prior employer's trade secrets. See 765 ILCS 1065/3; *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1267 (7th Cir. 1995). Indeed, in litigation intended to restrict the activities of a former employee, the battle is frequently won, lost, or settled based on issues related to trade secrets. Accordingly, when contemplating enforcement action against a former employee, an employer should focus on the need to protect its trade secrets and also look for any indicia of trade secret theft (e.g., unusual computer or e-mail activity shortly before an employee's departure).

3. An earlier version of this article was published in the April 2009 *Illinois Bar Journal*. Similarly, portions of this article were previously published by Peter A. Steinmeyer in Epstein Becker & Green, P.C.'s blog, tradesecretsnoncompetelaw.com.

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