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New rules enforcing Illinois non-competes—Now easier or harder?

By Richard A. Sugar

In a recent trifecta of Illinois Appellate Court cases, judges have altered the landscape in Illinois regarding the lengths to which employers can go to protect their customers, clients, patients, and marketplace from competition originating from former employees.

Non-Compete Must Be Reasonable and Based on Adequate Consideration

The landscape began to change in 2011 when the Illinois Supreme Court issued the decision, *Reliable Fire Equipment Co. v. Arredondo*. The Supreme Court acknowledged that, generally, any contract in restraint of trade is void as against public policy. The Court said a restrictive covenant, which is ancillary to a valid employment relationship, will be upheld if the restraint is reasonable and is supported by consideration. But the Court said a restrictive covenant is “reasonable” only if it (i) is no greater than is required for the protection of a legitimate business interest of the employer; (ii) does not impose undue hardship on the employee; and (iii) is not injurious to the public.

While citing this three-prong test for determining the reasonableness of a restrictive covenant, the Court said its application is unstructured and contains no rigid formula, meaning that reasonableness must be decided on a case-by-case basis. The Court specifically rejected earlier Appellate Court pronouncements which either ignored the legitimate business interest part of the three-prong test, or which created rigid, formulaic tests to determine whether a legitimate business interest existed at all. Instead, the Court

said factors to be considered in weighing the totality of circumstances to discover a legitimate business interest include, but are not limited to, the near permanence of customer relationships, the employee’s acquisition of confidential information through his employment, and the time and place restrictions.

Adequate Consideration

In the June 24, 2013 Illinois Appellate Court decision of *Fifield v. Premier Dealer Services*, the First District Illinois Appellate Court set down a new rule for determining whether a restrictive covenant is supported by adequate consideration so as to make it enforceable. The Court held that an employee, who can be fired at will, needs to be employed for no less than two years, or must receive some other compensation, in order for a restrictive covenant to succeed in blocking him from competing with his former employer. It is not enough, said the Court, for an employee just to be hired, or just to be retained in employment, to enforce a non-compete covenant. Surprisingly, the employee in *Fifield* negotiated the terms of his non-compete prior to his hire, eliminating its application if he was fired without cause during the first year of his employment. Moreover, the non-compete was limited to two years, post-employment, and had a geographical scope limit of the 50 states of the United States. Even though the employee quit after 31/2 months of employment, the Court nonetheless held there must be two or more years of continued employment to constitute adequate consideration in support of an employee’s restrictive covenant.

Legitimate Business Interest

In the April 15, 2013 First District Illinois Appellate Court decision of *Gastroenterology Consultants of the North Shore, S.C. v. Meiselman*, the Court precluded an employer from enforcing a restrictive covenant against a physician-employee who left, because the employer did not establish a legitimate business interest in need of protection based upon the totality of the circumstances. The employee had signed an employment agreement containing a restrictive covenant which prohibited him, for a period of 36 months following termination of employment, from soliciting or treating any patients within a 15-mile radius of each of the employer’s offices and Evanston Hospital facilities. However, the employee had practiced gastroenterology in the same geographical area for 10 years prior to being employed by the employer, treating thousands of patients. After employment, the employee continued to treat patients and accept referrals from sources with whom he had developed relationships prior to his affiliation with the employer, and continued to preserve his independent relationships with his patients. The employer was not materially involved with the employee’s practice, and his compensation was based upon the revenue generated by his independent practice. The employee also maintained his own office and had his own telephone number. Accordingly, the Court held that the employer never established a “near permanent relationship” with the patients treated by the employee, so the employer had no legitimate business interest to protect.

Undue Hardship on Employee Beyond What is Needed to Protect Legitimate Business Interest

In the May 8, 2013 First District Illinois Appellate Court decision, *Northwest Podiatry Center Ltd. v. Ochwat*, that Court addressed the circumstances of an employee who was subject to a restrictive covenant for a period of 36 months after employment terminated and within a five-mile radius of the offices of the employer. The restrictive covenant also required that the employee surrender all clinical privileges at any hospital or ambulatory surgical center at which employee held clinical privileges. The Appellate Court held that the lower court erred in imposing an injunction on the employee requiring clinical resignation without any temporal limitations. The Court pointed to the erroneous lower court order that required the employee to permanently resign all clinical privileges at the restricted facilities forever. Therefore, without a temporal restriction, the Court said that such a restrictive covenant is unreasonable as a matter of law.

TIPS: These cases remind us that there

are several prerequisites to enforcing a non-compete restraint upon employees in Illinois. First, the restraint must be reasonable. The reasonableness of employee restrictive covenants is generally based on intensive factual scrutiny by the courts which must now apply a loosely defined three-prong test. To be reasonable, one of the prongs of the test requires that the covenant must be no greater than necessary to protect employer's necessary and legitimate business interests. To have such an interest to protect, the totality of circumstances must demonstrate such an interest. Facts relevant to prove a necessary and legitimate business interest include the near permanence of employer's relationships with customers, the protection of employer's confidential information, and the reasonable limitations of time and geographical scope on the restraint.

Second, the covenant must be supported by adequate consideration—extended employment for at least two years, or some other remuneration.

Unspoken in this trilogy of cases are the exact parameters of "undue hardship on

the employee" and "injury to the public", the other two prongs of the Illinois Supreme Court reasonableness test. It may very well be that these latter two prongs of the test are so inexplicably linked to the "necessary and legitimate business interest" prong that they are implicit considerations in applying the "necessary and legitimate business interest" prong itself. However, the safer approach is to explicitly address all three prongs. Therefore, in drafting a restrictive covenant, or pleading to enforce a restrictive covenant, it will be advisable to recite the specific, detailed facts which satisfy all three prongs of the Illinois Supreme Court test, and which a judge can refer to, in determining the enforceability of the covenant. ■

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