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Non-Compete Agreements: Lessons from Illinois Courts

Labor & Employment partners Chad W. Moeller and William J. Tarnow authored an article entitled Non-Compete Agreements for Employment Law Strategist, a newsletter published by Law Journal Newsletters, a division of ALM. The article discusses the nature of today's workforce, which has prompted many employers to turn to non-compete agreements to protect their businesses. Below is the full article which was originally published in Employment Law Strategist's October 2013 edition.

Non-Compete Agreements *Lessons from Illinois Courts*

By Chad W. Moeller and William J. Tarnow II

The increasingly transient nature of today's workforce has prompted many employers to turn to non-competition agreements to protect their businesses. Non-competition clauses, and other such restrictive covenants (e.g., non-solicitation clauses), are contract terms designed to prevent employees from engaging in a wide variety of competitive, and potentially destructive, behavior. This includes working for a competitor, misappropriating or disclosing a company's trade secrets and/or other confidential information, and soliciting the employer's valued customers and employees.

These types of restrictive covenants can be invaluable to employers and promote business growth, as they allow

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companies to train employees and give them access to confidential information while minimizing the risk that a disloyal employee freely will disclose it to a competitor later. However, enforcing such restrictions against a disloyal former employee can be a challenging process, as the laws governing non-compete clauses vary from state to state, and may impose conflicting standards of enforceability.

In Illinois, the standard for restrictive covenant enforcement was addressed recently in *Reliable Fire Equipment Company v. Arredondo*, a landmark decision by the state's Supreme Court in 2011, and just recently followed by a related, and controversial, opinion by the Illinois Appellate Court in *Fifield v. Premier Dealer Services, Inc.*

As discussed below, the rulings in both cases have substantially defined the landscape of non-competition law in Illinois, and have a profound impact on employers' consideration and use of restrictive covenants with their employees.

The Reliable Fire Decision

Prior to the Illinois Supreme Court's decision in *Reliable Fire*, the state's courts determined the enforceability of non-competition agreements by evaluating the existence of a legitimate business interest for the employer-company and the reasonableness of the terms of the agreement.

A legitimate business interest existed if: 1) the employer's relationships with its customers were near-permanent, and the employee would not have had contact with those customers but for his or her employment with the employer; and/or 2) the employee had acquired confidential information from the employer and attempted to use such information for his or her benefit. The reasonableness of the agreement typically was

analyzed by examining its geographic and activity-related scope — that is, in which markets was the employee restricted from competing, and in what capacity — as well as the duration of the restriction (e.g., limitations lasting for one or two years after employment could be found reasonable).

This “legitimate business interest” standard eventually was called into question by some Illinois appellate courts. Most notably, the court in *Sunbelt Rentals Inc. v. Ehlers* held that the reasonableness, and thus enforceability, of a restrictive covenant should turn solely on its time and territory limitations, and the court dispensed with the legitimate business interest requirement altogether.

The resulting split among the various Illinois appellate courts over the proper standard of enforcement became the source of much confusion for employers, who faced uncertainty as to whether their existing non-competition agreements were enforceable potentially and, if so, under what circumstances.

The Illinois Supreme Court addressed this enforcement issue in its *Reliable Fire* decision. In that case, Arnold Arredondo and Rene Garcia were employed as sales associates at Reliable Fire Equipment Company (Reliable Fire), which primarily sells, installs and services portable fire extinguishers.

In 1997, both employees signed non-competition agreements with Reliable Fire in which they promised, among other things, not to compete with the company in Illinois, Indiana, or Wisconsin during their employment and for one year thereafter. Several years later, in 2004, Arredondo and Garcia entered into an operating agreement with High Rise Security Systems, a newly formed competitor that intended to supply fire alarm systems throughout the Chicago area.

Subsequently, Reliable Fire terminated Garcia's employment based on suspicion of his competition, and Arredondo resigned a short time later. Reliable Fire filed suit against Arredondo and Garcia, alleging that they had violated their restrictive covenants by providing services to Reliable Fire customers and soliciting business from Reliable Fire's referral sources. Arredondo and Garcia argued that the restrictive covenants were unenforceable; both the Illinois trial and appellate courts agreed, finding that Reliable Fire had not established the requisite "legitimate business interest" warranting the enforcement of the agreements.

The Reversal

The Illinois Supreme Court reversed, and stated that in order for a non-competition agreement to be enforced, it must be supported by adequate consideration — that is, a bargained-for benefit to the employee — and contain only reasonable restraints on competition. The court ruled that to be considered "reasonable," the restrictive covenant had to be ancillary to a valid employment relationship and then also satisfy a three-part test that requires the covenant to be: 1) no greater than is necessary to protect a legitimate business interest of the employer; 2) without undue hardship on the employee; and 3) without injurious effect to the public. The existence of a legitimate business interest, the court opined, must be judged based on the "totality of circumstances of the individual case." In so ruling, the court rejected the "rigid and preclusive" legitimate business interest test previously established by the Illinois courts (and which had been applied by the lower courts in the Reliable Fire case). Under the "totality of circumstances" standard, courts are free to consider all the unique facts and circumstances of each case — including traditional factors such as near-permanence of customer relationships, acquisition of confidential

information, and time and territory restrictions, but are not limited to a narrow analysis of those elements alone.

‘Totality of Circumstances’

In the wake of *Reliable Fire*, the existence of a legitimate business interest of the employer, as analyzed under the “totality of circumstances” test, is now typically the most hotly contested issue in evaluating the reasonableness of a restrictive covenant, with lower courts interpreting the standard to mean that the presence or absence of any one of the traditionally determinative factors is not dispositive. Some important factors that have been considered by courts under the “totality of circumstances” standard include the extent of an employee’s knowledge of and access to employer’s confidential information, whether an employer’s confidential information was publicly available and/or could be compiled independently, and the extent of an employer’s investment of time, effort or money in developing the employee’s relationship with customers.

The *Reliable Fire* decision generally favors a more expansive, business-conducive approach to the enforcement of restrictive covenants, but the fact-intensive nature of the “totality of circumstances” inquiry also means that an employer’s ability to enforce non-competition agreements can still be uncertain. Still, courts are now much less likely to dispose of non-compete claims on a motion to dismiss at the outset of litigation, and are instead likely to permit the case to move forward into the discovery phase in order to allow additional development of the facts.

The ‘Consideration’ Issue: *Fifield v. Premier Dealer Services*

More than a year after the Illinois Supreme Court’s decision in *Reliable Fire*, the state Appellate Court attempted to tackle the issue of consideration in the

context of noncompetition agreements. Again, as stated in *Reliable Fire*, a restrictive covenant must be supported by “adequate consideration” as a threshold matter, in order to potentially be enforceable.

It was generally established under Illinois law that non-competition agreements entered into by new employees are deemed supported by adequate consideration in the form of the offer of employment itself, while covenants entered into by current employees after the employment relationship already has begun — often referred to as “after-thought” agreements — may be supported by consideration in the form of continued employment for a “substantial period” of time after the employee signs the agreement.

For existing employees, Illinois courts generally have found that two years of continued employment following the execution of a restrictive covenant is “substantial” enough to serve as consideration for a non-competition agreement, with some courts having ruled that even one year may suffice; on the other hand, continued employment lasting only a matter of months would not qualify. The Illinois Appellate Court’s decision in *Fifield* effectively uprooted this body of precedent.

The Fifield Case

Eric Fifield was laid off when his division was purchased by another company. The purchasing entity subsequently offered Fifield a job, but required that he sign an agreement containing non-solicitation and non-competition clauses as a condition of employment. Fifield accepted and signed the restrictive covenant agreement, but then resigned from the purchasing firm to work for a competitor approximately three months after executing the covenants. Fifield and his subsequent employer then filed a motion requesting the court to invalidate the post-employment restrictions in the agreement.



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In granting the motion, the court held that even though *Fifield* had been a new employee at the time of the agreement's execution, neither the contemporaneous offer of employment nor his actual employment thereafter (i.e., lasting less than two years) could adequately support a covenant not to compete where the employment relationship was at-will, or any offer or promise of such employment effectively would be an illusory benefit.

The *Fifield* decision therefore would impose a bright-line requirement (as opposed to a mere benchmark) of two years of employment following the execution of a restrictive covenant, arguably regardless of whether that agreement is entered into at the beginning of or midway through the employment relationship, in order for sufficient consideration to exist in support of the agreement.

This ruling has been met with great skepticism, eliciting comments from numerous legal practitioners (these authors included) stating that the decision is a stark and inappropriate departure from the previously established rule that an offer of employment to a new employee is adequate consideration for an agreement containing post-employment restrictions. Commentators also have pointed out that the ruling is at odds with the law in at least 40 other states establishing that new employment is sufficient consideration to support a non-competition agreement.

Critics of the *Fifield* decision have argued that the ruling tends to undermine the employer's ability to enforce restrictive covenants in a variety of circumstances, and will act as an impediment to the growth of business in Illinois. Indeed, the Illinois Chamber of Commerce has criticized the *Fifield* ruling and supported the Plaintiff-Company's petition to the Illinois Supreme Court seeking to undo it.

Takeaways

The *Reliable Fire* and *Fifield* decisions largely fall on opposite ends of the spectrum with respect to Illinois' overall policy toward the enforceability of restrictive covenants. Unlike the expansive approach reflected in *Reliable Fire*, the court's decision in *Fifield* would preclude the enforcement of many non-competition agreements based on the issue of consideration alone. Although it remains to be seen whether *Fifield* will be reversed by the Illinois Supreme Court, the fact remains that both decisions are still binding currently.

Therefore, in order to safeguard the continued enforceability of previously executed restrictive covenants, employers should consider the standards articulated in both decisions and determine what type of contract review or other action is required. Minimally, employers should assess whether their non-competition agreements contain clearly defined and reasonable time, territorial and activity restrictions that do not impose greater limitations than are necessary to protect the employer's legitimate business interests.

The non-competition agreement also should be tailored to be enforceable under the employer's specific business circumstances.

Furthermore, employers that previously have entered into non-competition agreements with now-current employees are advised to identify individuals with access to particularly sensitive information, and consider whether to re-execute those restrictive covenants by offering some consideration other than continued employment in order to more definitively "seal the deal."

Finally, employers requiring that all new employees sign covenants not to compete as a condition of employment can consider whether to include some sort of additional consideration — such as a monetary payment or



enhanced tangible employment benefits — at the time of execution to ensure adequate consideration for the agreement.

Such measures can maximize the likelihood of enforcement of restrictive covenants against current and former employees, despite the ever-changing tide of non-compete law in Illinois. Of course, there is no “one-size-fits-all” solution, and the employer’s specific business circumstances and competitive concerns must be taken into account when developing the appropriate course of action.

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