

July 16, 2015

Federal Court Split on Consideration Needed to Enforce a Restrictive Covenant in Illinois Remains Unresolved

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On July 14, 2015, the U.S. Court of Appeals for the Seventh Circuit decided *Instant Technology, LLC v. DeFazio*.¹ The decision was widely expected to address the current split in the Northern District of Illinois on whether two years or more of continued employment is required to enforce a restrictive covenant, absent additional consideration, as opined by the Illinois Appellate Court in *Fifield v. Premier Dealer Services, Inc.*,² However, the Seventh Circuit did not address this issue and instead ruled that the district court did not abuse its discretion in finding the restrictive covenants in controversy were unenforceable under the facts of that case.

Background

Instant Technology, LLC (“Plaintiff” or “Instant”) is an information technology staffing firm where employees either recruit qualified candidates or pitch the candidates to the firm’s clients. As a condition of employment, Instant’s employees signed agreements not to solicit business from the firm’s clients, recruit the firm’s candidates or employees for other jobs, or disclose the firm’s confidential information to third parties. The named defendant was employed as Vice President for Sales and Operations (“vice president”) until Instant terminated her employment in January 2012. One month later, the former vice president and several of her former co-workers started a new tech staffing firm and successfully solicited business from several of Instant’s clients. Three of the defendants had been employed by Instant for less than two years before they left to form the new company.

Instant filed a lawsuit in the Northern District of Illinois against the former vice president and the four other former Instant employees (“the defendants”) with whom she formed the tech staffing company, alleging that—among other things—they breached the restrictive covenants in their employment agreements. In response, the former vice president filed a breach of contract counterclaim alleging Instant failed to pay her the remainder of a performance bonus that she had earned.

Before trial, the defendants argued that the restrictive covenants were not enforceable against three of the former employees because they were employed by Instant for less than two years. The district court agreed, and limited its analysis to the enforceability of the restrictive covenants

¹ Case Nos. 14-2132 and 14-2243 (7th Cir. July 14, 2015).

² 2013 IL App (1st) 120327. See also *McInnis v. OAG Motorcycle Ventures, Inc.*, 2015 IL App (1st) 130097 (June 25, 2015).

against the former vice president and one other former employee, both of whom worked for Instant for more than two years. In so holding, the district court relied on *Fifield* as creating a bright-line test, a conclusion challenged by two subsequent decisions in the Northern District of Illinois and one decision in the Central District of Illinois.³

After a bench trial, the district court ruled that the non-solicitation covenant and non-recruitment covenant in the former employees' employment agreements were invalid and unenforceable. The district court also held that the former vice president had failed to prove she was entitled to the remainder of her purportedly earned bonus. The parties filed cross appeals.

The Seventh Circuit's Analysis

The Seventh Circuit affirmed both of the district court's holdings. The court did so in a way that limits its broad-based applicability, finding that it was not an abuse of discretion for the district court to find that the Plaintiff had failed to establish that a legitimate protectable interest supported enforcement under the facts before the court. The court accepted as reasonable the district court's determinations that: Plaintiff did not demonstrate a protectable interest in its clients because the industry is not characterized by client loyalty; Plaintiff did not demonstrate that its candidate lists are valuable due to the information being accessible by other means and having a "short shelf life" of value; and Plaintiff did not demonstrate a protectable interest in a "stable workforce" to justify the nonrecruitment provisions, because its workforce was not stable.

The Seventh Circuit rejected the Plaintiff's argument that the district court erred in only considering these particular protectable interests, rather than the "totality of the circumstances" analysis set forth by the Illinois Supreme Court in *Reliable Fire Equipment v. Arredonodo*⁴ for two reasons. First, Plaintiff did not point to any circumstances that the district court "should have considered but didn't." Second, the totality of the circumstances analysis does not require a court to consider *all* of the circumstances underlying a restrictive covenant. Rather, the district court may limit its discussion to those it deems most material, a determination that will be upheld absent an abuse of discretion. The Seventh Circuit went on to lament that such a broad grant of discretion creates tremendous uncertainty as to which covenants courts will enforce, and identified perceived problems that such uncertainty creates. However, the court then commented, "Reforming that law, or trying to undermine it, is beyond our remit."⁵

Takeaway for Employers

Because the Seventh Circuit upheld the finding that the restrictive covenants at issue in *Instant Technology* were invalid due to a lack of a protectable interest, it did not need to address the question of whether the covenants could be dismissed for a lack of consideration enforced against those employees who had worked for Instant for less than two years, leaving the current split on this issue in the Northern District of Illinois unresolved. However, the Seventh Circuit's opinion provides insight into the application of the totality of the circumstances analysis used to determine the viability of a restrictive covenant in Illinois. The case also provides a roadmap to avoid the evidentiary shortcomings that the court determined were fatal to the Plaintiff's claims.

³ See *Bankers Life v. Miller*, No. 14cv3165, 2015 WL 515965, at *4 (N.D. Ill. Feb. 6, 2015) (Shah, J.) (rejecting *Fifield's* holding that absent material consideration, two years of continued employment is "required" before enforcing a post-employment restrictive covenant); *Montel Aetnastak, Inc. v. Miessen*, No. 13c3801, 2014 WL 702322, at *716 (N.D. Ill. Jan. 28, 2014) (Castillo, J.) (rejecting "mechanical" application of *Fifield's* two-year rule and instead favoring a fact-specific approach that focuses on whether the plaintiff was employed for a "substantial period"); and see *Cumulus Radio Corp v. Olson*, No. 15cv1067, 2015 WL 643345, at *5-6 (C.D. Ill. Feb. 13, 2015) (McDade, J.) (rejecting *Fifield's* bright-line rule and applying a "totality of the circumstances" approach).

⁴ 2011 IL 111871.

⁵ The Seventh Circuit also upheld the district court's rejection of the counterclaim, finding that the language upon which the counter-plaintiff relied was not susceptible to any reasonable interpretation, and therefore could not support the counterclaim.