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December 2011

# Illinois Supreme Court Expands Scope of Covenants Not to Compete

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On December 1, 2011, the Supreme Court of Illinois issued its opinion in *Reliable Fire Equipment Company v. Arrendondo*, Case No. 2011 IL 111871, addressing and clarifying several issues relating to the enforceability of noncompetition agreements in Illinois and setting forth a standard that may result in employers facing a lighter burden to enforce such agreements against former employees.

In *Reliable Fire*, the employer brought suit against two former employees for breaching noncompetition agreements, which prohibited them from competing against their former employer for one year and from engaging in solicitation of customers or employees of their former employer.

The two former employees brought a counterclaim seeking a declaration that the covenants were unenforceable, and the trial court found in favor of the former employees, concluding that the employer failed to prove the existence of a legitimate business interest.

A divided appellate court denied the employer's appeal, and the company then appealed to the Illinois Supreme Court. The supreme court reversed and remanded to the circuit court, finding that the lower court had applied an incorrect legal standard to the evidence presented.

In doing so, the supreme court set forth a detailed analysis of the history of Illinois law addressing noncompetition agreements. The court noted that Illinois had long ago established a "three-dimensional rule of reason," which is that a restrictive covenant, assuming it is ancillary to a valid employment relationship, must: (1) be no greater than is required for the protection of a legitimate business interest of the employer; (2) not impose undue hardship on the employee; and (3) not be injurious to the public. In doing so, the court rejected the reasoning in the recent appellate court decisions *Sunbelt Rentals and Steam Sales Corp.* that held that an employer's legitimate business interest was not a factor to consider in deciding enforceability.

However, the supreme court then went on to hold that, while an employer's legitimate business interest was a factor to consider, the three-prong test of reasonableness set forth above was "unstructured" and reasonableness must be considered "on an *ad hoc* basis," without any exact formula to be followed. As such, the supreme court criticized the structured formula that appellate courts had developed over the past 36 years to assess the legitimate business interest of the employer, where some factors were "highly weighted, if not conclusive." In particular, the court rejected the notion that the only legitimate business interests protectable under Illinois law were:

(1) trade secrets; (2) confidential information; and (3) "near-permanent" customer relationships.

Instead, the court noted that the reasonableness factors "are only nonconclusive aids in determining the promisee's legitimate business interest, which in turn is but one component in the three-prong rule of reason, ground in the totality of the circumstances." The court held that each case must be determined on its own particular facts, and the reasonableness of the restriction must be gauged by all of the circumstances, which the court noted may result in an identical contract being found enforceable under one set of circumstances, and unenforceable under another.

While the court did not overrule prior appellate decisions applying the previous limited "legitimate business interest" test, it noted that those cases only serve as nonconclusive examples of applying the promisee's legitimate business interest as a component of the three-prong rule of reason, and "not as establishing inflexible rules beyond the general and established three-prong rule of reason."

The court summarized its position regarding how courts should review an employer's legitimate business interest as follows:

> [W]hether a legitimate business interest exists is based on the totality of the facts and circumstances of the individual case. Factors to be considered in this analysis included, 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. No factor carries any more weight than any other, but rather its importance will depend on the specific facts and circumstances of the individual case.

## What the Case Means for Employers

This ruling is significant as it expands the scope of enforceable noncompetition agreements. Previously, in order to enforce an otherwise reasonable restrictive covenant, an employer would have been required to show that the former employee had and used confidential or trade secret information of the employer, or that the employer had near-permanent relationships with its customers that it needed to protect. However, following this decision, the types of "legitimate business interests" supporting a noncompetition agreement are no longer so limited. Nonetheless, the court affirmed that some legitimate protectable interest must still be shown by the former employer. This change makes Illinois law similar to many other states in this regard, unlike the past, where the Illinois enforceability test was more rigorous in many circumstances.

In addition, the court's emphasis on reviewing restrictive covenants, including the legitimate business interest sought to be protected, on a case-by-case basis, indicates that it will be more difficult for defendants to dispose of noncompetition agreement claims through a motion to dismiss.

Employers should consider this new guidance from the Illinois Supreme Court in drafting noncompetition agreements and when seeking to employ individuals who have signed noncompetition agreements with their former employers.

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