legal lines

from

MOORE, SUSLER, MCNUTT & WRIGLEY

Lawyers

EMPLOYMENT COVENANTS NOT-TO-COMPETE

By Bill McNutt

Do I have to sign this?,

…Matt said to himself. His boss at Acme Products Company had just presented him with the company's new confidentiality and covenant not-to-compete agreement. Matt was the leading outside sales representative for the company. In the 5 years he worked for Acme, he increased sales an average of 10% per year. The agreement stated that if Matt's employment at the company terminated, he could not try to take the company's customers with him. The agreement further provided that for a period of two years following separation, Matt may not engage in "any activity" that is "competitive" to the company business. Because it was late Friday afternoon Matt begged off, asking and receiving the weekend to read and study the agreement. On Monday morning he is in his lawyers' office seeking advice.

What should Matt do? Should he sign it? What happens if he agrees? What if he asks for some changes? What if he doesn't sign? If Matt decides to take a job with the company's competitor, is the agreement enforceable?

Enforcement

In Illinois, "reasonable" covenants not-to-compete are enforced. The courts hesitate to place restrictions on any employee's right to compete in a field in which he or she is most familiar. However, judges recognize the major concerns for businesses to protect both sensitive trade secrets, and customer relationships. Companies may invest lots of time and money to build up its sales representatives. If an employee leaves, taking all of the information and skills acquired to the new company, then irreparable damage can result. Accordingly, Illinois has developed the basic test of "whether the covenant is reasonably necessary to protect the employer from improper or unfair competition." Factors used to determine reasonableness are: (1) The employer's need to protect a legitimate business interest; (2) the hardship to the former employee in terms of time, territory or activities, and (3) the likely injury to the public.

Before an employee discounts the effect of a signed covenant not-to-compete, the employee must consider the practical and economic issues. First, most employees do not have the financial savings necessary to take the old employer to court to challenge the reasonableness of the agreement. Second, even if found unreasonable by a court, the agreement may still be partially enforced by striking the offensive terms and substituting reasonable ones. Third, given that the new employer can be sued for injunctive relief and damages, including attorney's fees, what competitor company would take the economic risk of protracted litigation by hiring such an employee?

Legitimate Business Interests Needing Protection

An employer cannot extract a restrictive covenant from an employee merely to protect itself from all competition. There must be some legitimate protectable interest of the employer to be served. Protectable interests are two-fold: (1) Where the employee acquired confidential information through the business, or (2) where, by the nature of the business, the customer relationship is near-permanent and, but for the employee's association with the business, the employee would not have had contact with the customers.

Continued…

Dan Moore Honored as Laureate

Regents of the academy of Illinois Lawyers have selected Dan Moore as one of its new inductees for the year 2002. He is one of only twelve new Laureates selected. The selection recognizes Dan's high legal and ethical standards in the legal profession. Dan is a past President of the Decatur Bar Association, Past Chair of the Illinois State Bar Association (ISBA) Elder Law Section Council, and he was the 1996 recipient of the General Practice Tradition of Excellence Award.

The Laureate presentation of the class of 2002 will be the highlight of the ISBA 125th anniversary banquet. The gala dinner will be held on March 12, 2002, at the Crown Plaza Hotel in Springfield.

We congratulate Dan on achieving yet another outstanding recognition in his exemplary law practice.

Confidential information or trade secrets have long been regarded as legitimate protectable interests. It must be "something held in secret or confidence" and relate to the operation of the particular trade or business. If it is of general knowledge, something disclosed in business catalogues or publications, or are readily disclosed by the product itself, then it is not a trade secret.

Customer contacts can be protected if the employer can show that a near permanent relationship existed and that the former employee would not otherwise have had contacts with the customer. Objective factors include (i) number of years developing a customer base; (ii) money invested by the business; (iii) difficulty of developing customers; (iv) the degree of working relationship between the business and its customers; (v) the business' intimate knowledge about its customers; and (vi) the length of the business-customer relationship.

Thus, either confidential information or a near permanent customer base is a legitimate business interest that Illinois courts will preserve in a reasonable covenant not-to-compete.

Reasonable Terms

Whether a restrictive covenant is reasonable depends on its geographical, temporal, and activities limitation. There are no hard and fast rules, and each case is decided on its own facts.

Generally, the larger the geographic limitation, the more risk that the agreement will not be enforced. On the other hand, where the territorial restriction does not extend beyond the area in which the employee formerly worked, it is probably reasonable.

A time limitation is also assessed on the particular facts of the employment. Generally, the time limit should not extend beyond what is needed to protect the legitimate business interests. For example, where the evidence showed that it takes two to three years for the business to develop a major account, the two-year restriction was found reasonable.

Finally, the restricted activities are also assessed on a case-by-case basis. If the covenant not-to-compete totally prohibits the employee from engaging in her occupation, its reasonableness will be questionable. If the employee is only prohibited from soliciting actual customers of her former business, the courts will usually allow the employee to solicit other potential customers.

Injury To Public

In a competitive economic system, restraints in competition are considered a potential injury to the public. But while courts routinely acknowledge this prong of the reasonableness analysis, they most frequently ignore the issue. For example, where a covenant not-to-compete restricts the number of doctors or other health professional to a community, the Illinois courts have not been persuaded that a significant adverse risk to the public is created. On the other hand, when a covenant restricted the number of bidders available for government jobs, the contract was held to injure the public and was unenforceable.

The New "Golden Rule"

Therefore, it is wise for the employee to consider the so-called "New Golden Rule". Cynically, that rule states: "Those that have the gold make the rules." In a typical case where the old employer tries to enforce the covenant, it is likely that it can get to the preliminary injunction stage. Thus, it becomes so expensive and burdensome on the employee and the new employer, that they just give up and agree to abide by the agreement.

Conclusion

Covenants not-to-compete are enforced in Illinois, but they must be reasonable, a business must have a legitimate protectable interest, and the terms cannot exceed what is reasonably necessary to restrict the former employee in activities, territory, and time. In addition, the agreement must not adversely affect or ignore the public welfare. Written covenants not-to-compete always impose an onerous burden on the employee in his search for other work. Even where it appears that the covenant may be unreasonable, the expense of litigation is often enough to dissuade an employee from leaving or from trying to compete after employment separation. Before entering into such an agreement, competent legal advice is needed by both sides, the employer and the employee, to reach mutually acceptable terms that will benefit everyone involved.

Welcome St. Teresa Educational Foundation

Beginning on January 1st, the St. Teresa Educational Foundation relocated its office to the suite in the southwest corner of our building. We welcome Foundation Executive Secretary, Lowell Brosamer, and his secretary, Annette Sheehy, as new tenants in our building. The space has been made available to the foundation free of charge as an in-kind donation to the Foundation. Partner Bill McNutt, who is also serving as the current President of the Foundation, stated, "We are very pleased that we could offer this unused space to Lowell and the Foundation, both of whom are very important components to the success of private education in the Decatur Area."

Moore, Susler, McNutt,
Wrigley & Root, L.L.C.
3071 North Water Street
Decatur, IL 62526-2464

(217) 872-1600

Vol. II, Issue 8 - March, 2002