

# KIRKLAND ALERT

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## New Illinois Supreme Court Decision Requires Detailed Analysis of Restrictive Covenants

Many employment lawyers believe that Illinois courts are generally hostile to employer-employee non-compete agreements. Outcomes in Illinois restrictive covenant cases have long been unpredictable, highly dependent on the equities, and heavily influenced by the quality of advocacy.

In *Reliable Fire Equip. Co v. Arredondo*, 2011 IL 111871 (Slip. Op. Dec. 1, 2011), the Illinois Supreme Court exacerbated these concerns by rejecting 30 years of appellate court decisions establishing “conclusive” tests for the enforcement of restrictive covenants. Instead, the Court held that the enforceability of a restrictive covenant will turn on the unique facts and circumstances of each case, with no single, determinative factor. In what is sure to create uncertainty, the Court held that “[t]he same identical contract and restraint may be reasonable and valid under one set of circumstances, and unreasonable and invalid under another set of circumstances.”

Prior to *Reliable Fire*, Illinois (like many states) would enforce a restrictive covenant only if the employer established that the covenant was no broader than necessary to protect a “legitimate protectable interest.” Over time, the Illinois appellate court recognized only two such protectable interests: (1) “near-permanent” customer relationships; and (2) confidential information.<sup>1</sup> Many Illinois businesses — particularly sales businesses — could not meet this test and had difficulty drafting enforceable covenants.

Serious challenge to this decades-old Illinois regime began in 2009 with *Sunbelt Rentals v. Ehlers*.<sup>2</sup> Purporting to trace the “legitimate protectable interest” test back to its genesis, *Sunbelt* concluded that the test itself had no basis in Supreme Court case law, and held that an employer need not establish a legitimate protectable interest at all. Instead, the *Sunbelt* court held that an employer seeking to enforce a restrictive covenant need only demonstrate its reasonableness. This decision was criticized by other courts, and led to the Supreme Court’s ruling in *Reliable Fire*.<sup>3</sup>

*Reliable Fire* presented a common fact pattern. Reliable hired Arredondo to sell fire alarms and equipment. He signed an agreement prohibiting him, for one year after leaving Reliable, from: (1) selling similar goods in Illinois, Indiana, or Wisconsin; and (2) soliciting Reliable’s customers or employees. When Reliable learned that Arredondo and another former employee had formed a new competing business, it sued, claiming that defendants had breached their restrictive covenants.

The Circuit Court held a bench trial and determined that the restrictive covenants were unenforceable because Reliable’s customers were not “near-permanent” and there was no evidence that confidential information had been misappropriated; thus, no legitimate protectable interest existed sufficient to justify Reliable having restrictive covenants. In a split decision, the appellate court affirmed, but the Illinois Supreme Court reversed and remanded. The Court’s holding includes three key points.

*First*, the Court reiterated that all non-compete agreements in Illinois are subject to a “rule of reasonableness test.” Under that test, a restrictive covenant is reasonable only if it: (1) is no greater than is required to protect a legitimate business interest of the employer; (2) does not impose undue hardship on the employee; and (3) is not injurious to the public.<sup>4</sup> The Court thus reaffirmed the longstanding requirement that, to enforce a restrictive covenant, an employer must demonstrate *both* a legitimate business interest *and* that the activity, time and geographic restrictions in its covenant are reasonable, overruling *Sunbelt*.

*Second*, the Court rejected a long line of appellate court precedent limiting the available “legitimate protectable interests” to either “near-permanent” customer relationships or confidential information. Instead, the Court

held that these factors should be “nonconclusive aids in determining the promisee’s legitimate business interest, which in turn is but one component in the three-prong rule of reason, grounded in the totality of the circumstances.” According to the Court, the past three decades of “legitimate protectable interest” precedent “remains intact,” but only in identifying nonexclusive examples of legitimate business interests, not as “inflexible rules” that only two such interests exist.<sup>5</sup>

*Third*, the Court solidified Illinois as a “rule of reason” state, holding that “whether a legitimate business interest exists is based on the totality of the circumstances of the individual case. Factors to be considered in this analysis include, 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.”<sup>6</sup>

The “totality of the circumstances” analysis is likely in practice to be less rigid than prior Illinois restrictive covenant law. Indeed, particularly interesting was the Court’s reliance on precedent from many different jurisdictions — among them New York, West Virginia, Ohio, Nebraska, and Massachusetts — as well as law review articles and treatises generally discussing the “rule of reason” approach to restrictive covenant jurisprudence. The Illinois Supreme Court’s elimination of the strict guideposts under which such covenants have historically been analyzed in Illinois will leave enforcement of those contracts largely to the

discretion of individual judges in fact-specific situations.

In light of *Reliable Fire*, Illinois employers should take a fresh look at their employment agreements. Sound drafting with narrowly defined restrictions and an explicit connection between the restraint and the realities of a particular business will have concrete benefits for employers who—perhaps years later—seek to enforce their agreements in a court of law.

For the advocate, *Reliable Fire* creates new possibilities. The longstanding body of “legitimate protectable interest” precedent remains good law, but has been relegated to part of a multi-factor test that has yet to be articulated to any material extent. Creativity, flexibility, and a willingness to weave traditional Illinois standards with detail-oriented analyses of the business at issue will give trial lawyers (and their clients) significant advantages as the contours of *Reliable Fire* are defined in future cases.

<sup>1</sup> *E.g., Outsource Int’l, Inc. v. Barton*, 192 F.3d 662, 666 (7th Cir. 1999).

<sup>2</sup> *Sunbelt Rentals, Inc. v. Ehlers*, 394 Ill. App. 3d 421, 915 N.E. 2d 862 (4th Dist. 2009).

<sup>3</sup> *Reliable Fire Equip. Co. v. Arredondo*, 405 Ill. App. 3d 708, 940 N.E. 2d 153 (2d Dist. 2010); *Pampered Chef v. Alexanian*, No. 10 C 1399, 2011 WL 2746460, at \*12 (N.D. Ill. July 14, 2011).

<sup>4</sup> *Reliable Fire*, 2011 IL 111871, Slip. Op. at 9-10.

<sup>5</sup> *Reliable Fire*, 2011 IL 111871, Slip. Op. at 14.

<sup>6</sup> *Reliable Fire*, 2011 IL 111871, Slip. Op. at 12.

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