

ILLINOIS SUPREME COURT RESOLVES SPLIT
ON ENFORCEMENT
OF NON-COMPETE AGREEMENTS

Last April, the Illinois Bankers Association featured an article in the Illinois Banker Magazine on *Recent Developments in the Enforcement of Restrictive Covenants* (the “*Recent Development* article”). That excellent article identified the split in the Illinois appellate courts regarding the elements necessary for an employer to enforce a restrictive covenant agreement (such as a non-compete agreement). The Illinois Supreme Court has now addressed that split and clarified the law for all employers, including banks, moving forward. (*Reliable Fire Equipment Co. v. Arrendondo*)

In its December 1st decision, the Court addressed two issues of significance for employers: (1) whether employers must prove they have what is referred to as a “legitimate business interest” in order to enforce a restrictive covenant; and (2) if so, what is the proper standard to apply in analyzing whether employers have a legitimate business interest.

As background, for many years, Illinois trial and appellate courts had maintained that an employer could only enforce a restrictive covenant if it had some business interest that needed protection. In other words, an employer could not enforce a restrictive covenant simply because an employee (often at the time of hire) was willing to sign such an agreement. Instead, the restrictive covenant was *only* enforceable if the employer had a legitimate business interest, such as a trade secret or long-standing relationship with a customer, that needed protection. That approach made sense as it only prohibited “unfair” competition – such as an employee learning a trade secret and then quitting to take it to a competitor; or being introduced to the employer’s most important client and then trying to take that customer to a competitor. In those situations, the employer would be entitled to some limited protection from competition. That long-standing legal landscape began to change several years ago when an appellate judge wrote several opinions claiming the Illinois Supreme Court had never endorsed the legitimate business interest approach. Thereafter, one appellate court agreed with that view; another, in reviewing the case ultimately appealed to the Supreme Court, disagreed.

In relatively short order, the Illinois Supreme Court stepped in to conclusively resolve this split of authority in Illinois. The Court began by highlighting the recent appellate court opinions which held that a legitimate business interest was not a required showing when enforcing a restrictive covenant. The Court quickly expressed its disagreement stating we “now take the opportunity to correct this misconception.” In overruling those two decisions, the Supreme Court exhaustively reviewed six of its own opinions dating back to 1873. It noted that it had long upheld valid restrictive covenant agreements if they contained a “reasonable restraint.” For example, it had found that it was reasonable for the buyer of a business to expect that the seller of the business would not try to continue to do business with its former customers after it sold the business. Similarly, it had found that the doctors in a medical practice had a legitimate interest in protecting themselves against the competition of a doctor departing from the practice. The Court then specifically endorsed what it called the modern application of this reasonable restraint standard – a three-pronged test, whereby a restrictive covenant is enforceable only if it:

1. is no greater than is required for the protection of a legitimate business interest of the employer;
2. does not impose undue hardship on the employee; and
3. is not injurious to the public.

Having resolved the issue of whether a legitimate business interest must be shown (it must), the Court then addressed the proper application of this element of the reasonable restraint test. It noted that in the decision it was reviewing, the appellate court judges had been unable to agree on what approach an employer must use to establish that it had a legitimate business interest in need of protection. The lead opinion had applied various rigid “tests” or “lists” which had developed in a series of appellate court opinions dating back for 36 years (the *Recent Development* article contained an excellent discussion of those various tests). A concurring judge agreed with the lead opinion’s result (i.e., that the restrictive covenant at issue should not be enforced) but stated that the determination of whether a legitimate business interest exists should be reviewed with regard to the “totality of the circumstances” rather than any of the rigid tests which had developed over the years.

Again, the Supreme Court stepped in to resolve the issue. It stated that the best method of analyzing a restrictive covenant agreement is to weigh the “totality of the circumstances.” Doing so, the Court noted, will lead to results more grounded in the true considerations of a given case. In trying to provide guidance on reviewing the “totality of the circumstances,” the Supreme Court noted that parties have long turned to the many court decisions from the Illinois appellate courts to argue for or against the enforceability of restrictive covenant agreements. The Supreme Court found this long line of cases presented an “especially well-developed and significant body of judicial decisions” for applying what it considered the “general rule of reason.” While it was careful to state that no single case had a “conclusive” test and to emphasize that each case needed to be examined on its own particular facts, the Supreme Court expressly observed that the 30-years of case precedent remained as examples of where the legitimate business interest was properly reviewed. In so finding, the Supreme Court further noted that the two traditional legitimate business interests recognized in Illinois (i.e., confidential information and near-permanent relationships with customers) may not be the only circumstances which support an employer’s legitimate business interest.

The result for employers, including banks, should be to streamline the issues to be contested in restrictive covenant cases: employers and employees will no longer have to argue as to what standard should apply and can focus on why the restrictive covenant is necessary, reasonable and enforceable in each particular matter. For banks considering adopting such agreements, it will be more important than ever to examine and document the business reasons supporting why a particular employee or set of employees should be required to sign one.