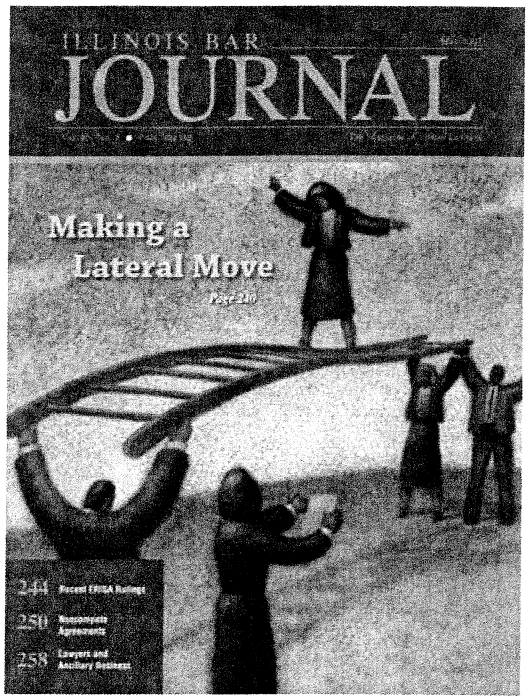
ILLINOIS BAR JOURNAL
THE MAGAZINE OF ILLINOIS LAWYERS

May, 2007 VOLUME 95 Pages 221-276 NUMBER 5

COVER STORY 240



COLUMNS

PRACTICE NEWS

ARTICLES

Employment Law

Litigating Noncompetition Agreements: The Employee's Perspective

By Patrick M. Kinnally

Your client's former employer goes to court seeking a TRO to enforce a noncompete agreement against him. What do you do? Here are tips.

Enforcing noncompete or nonsolicitation agreements from the employee's perspective is often about staying power against a well-heeled opponent. It is also about going from zero to 60 in a hurry. Because noncompete litigation typically begins with an employer's complaint and motion for a temporary restraining order, decisions must be fast and furious. In Hobbesian terms, injunction litigation is often nasty, brutish, and short.

From your standpoint as advocate for the employee, a noncompete lawsuit is about dropping everything else you are doing, so you can (1) prepare a verified answer to the employer's motion for a TRO or a preliminary injunction ("PI"), (2) interview your client and as many others as possible, (3) obtain a copy of the client's personnel file, (4) assemble your evidence into a persuasive theory of defense, and (5) figure out what it all will cost.

This article discusses how to approach the employer's petition for injunctive relief and looks at the factors courts use to determine whether a noncompete provision is enforceable. In addition, it offers pointers for defending against charges that your client violated his or her duty of loyalty to an employer or misappropriated confidential information.

Injunctions - your client and the process

From the time you're contacted by the client until the TRO hearing, the typical case requires your unqualified attention. Weigh that when you set your fee.

Different courts, different rules. Different rules apply depending on whether you are in state court or federal court, so read the rules.[1] For example, judges in Cook County often enter a TRO - for 10 days or until there is a hearing on the motion for preliminary injunction[2] -based on the verified complaint and supporting affidavits, regardless of whether an answer is filed.

In lower volume state courts, the judge will probably not automatically enter a TRO, instead setting the matter for hearing on the PI within two weeks. Check the local rules and call the judge's clerk to find out how he or she typically handles TROs before you proceed. If the TRO is going to be entered even if you file an answer, why do it and needlessly educate your opponent?

Do you need discovery? Next, determine whether you need discovery. Among other downsides, discovery usually means reviewing reams of client customer lists in production requests, locating witnesses and talking to them (which may be discoverable and may pose problems for your defense if you record the interviews) and fighting with your opponent about dates for depositions, protective orders and SCR 213 interrogatories. That takes time, and time is your enemy.

Unless the upside is overwhelmingly favorable for your client, performing discovery from the employee's

perspective might not be worth it. You may be better off going into the hearing with nothing more than your own well-prepared witnesses. The spontaneity of a trial often helps an employee. Remember, the burden of proof is on the complainant, not your client.

TROs - not all or nothing. Even if a TRO is entered against your employee-client, that's not the end of the exercise. Nor does it give your opponent a leg up. The court has merely looked at the pleadings filed and determined prima facie eligibility for the relief sought. If you have not filed an answer, then the court has not adjudicated any facts your client has interposed.[3]

In short, the plaintiff's lawyer has obtained the TRO based on what he or she knows about his case at that point. That may not be everything. The employer has only told one side. Usually, there are at least two.

Finally, injunctions are interlocutory in nature. They can be modified as well as dissolved depending upon a change in circumstances. That can occur at any time, not just the dates when hearings are scheduled. Because an injunction is an extraordinary remedy, courts recognize their temporal elements and are reluctant to enter them where money damages can provide an adequate remedy.[4]

Therefore, there are a few rules that you need to remember. First, if you're defending a contract action and the plaintiff is pleading the performance of a condition precedent in a contract, he must allege that he has performed all of its conditions.[5] If you are going to deny those facts, then you must interpose where the plaintiff did not perform. For example, if you, as the employee, allege there is a failure of consideration, then you must not only plead it but prove it.[6] Contrariwise, the plaintiff should do as well. If he does not, then the court should not enforce the contract.

And if a TRO is entered by the court before you file an answer, all is not lost. First, the court should require the plaintiff in such circumstances to post a bond.[7] If the TRO is wrongfully issued, you can seek to recover the actual damages sustained on that bond.

You can move to dissolve the TRO or the preliminary injunction and ask the court to assess damages because injunctive relief was entered wrongfully.[8] Such a recovery includes actual damages incurred during the time the injunction was entered, as well as attorney's fees and costs in defending.[9]

TRO template. A preliminary injunction is an interlocutory remedy granted to preserve the status quo until the court has the time to hear the merits of the case. When it does so, it must follow a rather specific template as to what the proponent of the injunction must show.[10]

What the plaintiff must show is pleading as well as proof establishing that (1) there is a clear right or interest needing protection, such as a near-permanent customer relationship or confidential information (and the offending employee would not have had contact with the customer absent his employment with the former employer);[11] (2) there is no adequate remedy at law; (3) irrep-arable harm *will, not might*, result if a preliminary injunction is not granted; and (4) there is a reasonable likelihood of success on the merits[12] For the most part, these are fact-based determinations made in the trial court.

Keep an eye on your record and make sure the plaintiff's proof meets the requirements for obtaining an injunction. Whether an injunction should be granted revolves around whether or not the covenant is enforceable.

In this regard, a trial judge's determination to authorize a preliminary injunction will not be overturned on appeal unless there was an abuse of discretion. The standard of review is whether the trial court's decision, and necessarily the findings made to reach that decision, were against the manifest weight of the evidence.[13]

This standard is very deferential. Basically, it denotes that unless the opposite conclusion is clearly

evident, then the trial court's decision is not against the manifest weight of the evidence. Thus, winning in the trial court is paramount, and it is where all of your energy needs to be devoted.

All of the trial court's evidentiary considerations receive limited review. Notwithstanding, there is a silver lining in the appellate court, because the determination of whether a restrictive covenant is enforceable is a question of law.[14] In short, on that issue in the reviewing court you will get a fresh legal analysis regardless of what the trial court concluded.[15]

Noncompetition and nonsolicitation clauses and near-permanent relationships

Restraints must be reasonable. Employers use various types of agreements to limit the business threat posed by former employees. These may appear in shareholder, sales, or, more typically, employment agreements ancillary to the sale of a business. They include general non-competition restraints, customer nonsolicitation provisions, employee nonsolicitation pacts, and nondisclosure contracts.[16]

Generally, these agreements are enforceable if they are part of a valid contract, are necessary to protect an employer's legitimate business interests, and are reasonable in duration, territory, and activity.[17] A noncompetition agreement can be ancillary, not only to a valid contract, but also to a valid at-will employment relationship.[18] Noncompetition agreements in conjunction with the sale of a business seem to be significantly favored,[19] and confidential information that amounts to a trade secret will be protected.[20]

However, merely avoiding competition is not a legitimate business interest, nor are restrictions on contacting customers where there is no near-permanent relationship with them.[21] The question, then, is whether the restrictions the employer has placed on the employee's post-employment activities protect a legitimate business interest and are reasonable, which is to say they do not impose an undue burden on the employee or the public.[22]

Put another way, restrictive covenants are designed to protect confidential information and near-permanent customer relationships against misappropriation and solicitation. They will be struck if (1) they are a restraint on trade and the employ-ee's ability to engage in a chosen profession[23]and (2) they are not reasonably necessary to protect the employer from improper and unfair competition.[24]

Nonsolicit more limited, surgical than noncompete. From the employee's perspective, the distinction between a non-solicitation agreement and a noncom-petition agreement can be important. A covenant not to solicit receives a lower level of scrutiny by the court than a covenant not to compete.[25] It does not prohibit competition but only solicitation with customers the employee serviced while employed.

A noncompetition agreement means your client cannot compete at all regardless of whether he served the clients as an employee. That can be an important distinction.

Customer nonsolicitation agreements, unlike noncompetition covenants, are basically activity restraints. This means the employee, while not prevented from working for a competitor, may not solicit the former clients of the employer. Customers are off-limits only if the employer had a near-permanent relationship with them (see below).

A reasonable geographic scope is a central requirement of valid contracts restricting the competitive activities of employees and agents. Noncompete agreements try to satisfy this requirement by expressly limiting their reach to a particular geographic territory. Nonsolicitation contracts, on the other hand, define their geographic scope by restricting competitive activities to certain customers of the employer.

Therefore, nonsolicitation agreements are usually less onerous than noncom-pete agreements, because the latter inhibit or ban competitive activities with competitors who had any dealings with that employer or about whom the employee ever possessed any confidential information.[26] Noncompete agreements try to

foreclose competition in the geographical area with entities that never had any business relationship with the former employer.

Near-permanent relationships. Some businesses are more likely to result in near-permanent relationships than others. Companies engaged in sales generally do not have near-permanent relationships with their customers.[27] In *Hanchett Paper Co v Melchiorre,*[28] the second district appellate court used this test in classifying the customers of a sales company selling non-unique packaging products to validate a covenant not to compete. The first district on similar facts found just the opposite concerning a company that sold shrimp.[29] On the other hand, businesses providing professional services or those selling unique products are more likely to be able to establish near-permanent customer relationships.

Courts look at seven factors in determining whether a near-permanent relationship exists: (1) the number of years it takes the employer to develop its clientele; (2) the money it invested to do so; (3) the difficulty it faced when acquiring customers; (4) the extent of the employee's personal contact with the customer; (5) the employee's knowledge of the customers; (6) the length of time the customers have been associated with the employer; and (7) the continuity of the customer relationships.[30]

Also, in determining whether a restriction on competitive contact with customers with whom an employee did not have any contact during the course of his employment is reasonable, courts consider the following factors: 1) the nature, value and character of the information obtained; 2) the extent to which such information is vital to the employer's ability to conduct business; 3) whether the employee had access to such information; 4) whether the information could be obtained through other non-confidential sources.

You must discuss these sets of factors with the employee and educate yourself thoroughly about the facts to represent him or her competently.

The obligation of loyalty - important, but not all-encompassing

Employees owe a fiduciary obligation, that of loyalty, to their employer. This duty is often misunderstood. Generally, the duty of loyalty emanates from the Restatement of the Law of Agency, which says that "[u]nless otherwise agreed, the authority of an agent terminates if, without knowledge of the principal, he acquires an adverse interest or if he is otherwise guilty of a serious breach of loyalty to the principal."[31]

Lawyers representing an employee (or an employer, for that matter) must understand this legal concept. In short, the employee, as the agent of the employer, has a fiduciary obligation to treat his employer with candor, loyalty, and good faith.

This means, for example, that an employee can't usurp a corporate opportunity without first permitting the employer to take it, or compete with the employer against its interest. He or she can't take advantage of knowledge acquired in an employment relationship to profit personally at the expense of the employer. In short, the employee can't cheat.[32]

However, once the employment relationship is terminated, so is the fiduciary relationship. And the duty of loyalty is not all-encompassing.

This latter point is illustrated by the federal district court case *Beltran v Brentwood North Healthcare Center, LLC*.[33] In *Beltran*, certain employees of the Brentwood nursing facility were terminated. They claimed the facility violated state and federal laws relating to the payment of unpaid wages. Brentwood filed a counterclaim alleging that it owed them no back wages and that the plaintiffs breached their fiduciary duty of loyalty by sleeping on the job. Brentwood claimed the plaintiffs should repay all the wages they received. Naturally, the plaintiffs claimed this counterclaim was frivolous and in retaliation for filing their federal and state wage claims.

The district court found that Brent-wood's counterclaim was not frivolous but also declared sleeping on the job was not a breach of an employee's fiduciary duty. Examples of breach include competing with a former employer, soliciting customers, enticing co-workers away, diverting business opportunities, self-dealing, or otherwise misappropriating the former employer's property or money.[34] In essence, the court found, poor job performance is not tantamount to breach of a fiduciary duty.[35]

Confidential information - what it is and isn't

Your client might be accused of mis-appropriating or misusing confidential information. But just because someone says something is confidential does not make it so. Here are some questions you should ask on behalf of your employee client.

1. Talk to current or former employees of the company and find out whether they were ever informed by the employer that the information in question was "confidential" and not to be disclosed.
2. Find out how the employer retains information. Is it kept in a locked office? Is it separated from other general information? If it is kept electronically, who has the access code? Has the code ever been lost? Has unauthorized access ever been gained? Who has access? Is there a log? Have any who had access left the organization? Is a cipher program used to encrypt confidential software?
3. Find out how confidential information is communicated to those within and outside the organization. Is it passed to those outside the "control group" of the organization? Is it randomly disseminated? Is it labeled "confidential"?
4. Determine which employees do and do not have confidentiality and restrictive covenant agreements as to the information. Do any who do not nonetheless have access to such confidential information? Has the employer litigated any restrictive covenants with former employees? If so, find out the details.

Final tips

Noncompetition and nonsolicitation agreements are often hard for employ-ee's counsel to address. Most noncom-pete cases are fact specific. They require knowledge of the industry covered by the agreement and a thorough understanding of how the agreement was negotiated and executed, as well as its competitive impact.

Moreover, the true equity of the situa tion, which includes an understanding of an employee's loyalty and fiduciary obligation to his employer, must be addressed in an objective way. Make sure the client understands all of these factors from the outset of your engagement.

You should also take the following steps.

1. Determine whether consideration was given for the employee signing of the agreement originally. If the agreement was assigned to a new employer, what was the consideration? Check personnel files and see what documents actually exist.
2. Locate state and federal criminal and civil statutes that apply to the industry to which the covenant pertains. Use these to show that enforcing the covenant violates public policy.[36]
3. Try to show the other party materially breached the agreement and therefore cannot enforce the contract.[37] Re-member, parties to an agreement have the obligation to deal fairly and in good faith with each other; such a covenant is implicit in every Illinois contract.
4. Seek to establish that the contract is ambiguous as to its essential terms. Show that it is unreasonable as to the standard in the industry for noncompetition restraints based on the duration of customer loyalty.[38]
5. . Avoid the use of affidavits when applying for an injunction. They only serve as a script for cross examination of your witness. A witness should be more convincing than a piece of paper. Make sure your opponent's affidavits comply with SCR 191.

6. If time permits, use SCR 213 to your advantage in making the corporation state not only the status of its witnesses[39] but also what their opinions are as to the topics. Then, use that SCR 213 answer as the basis for your cross examination.

Patrick M. Kinnally is a partner in the Aurora firm of Kinnally Flaherty Krentz & Loran, P.C., where he practices in the areas of civil litigation, local government, and immigration law.

---

1. 735 ILCS 5/11-101 et seq; FRCP 65.
2. *Kable Printing Co v Mount Morris Bookbinders Union*, 63 Ill 2d 514, 349 NE2d 36, but see Michael D. McCormick, *Emergency Injunctive Relief in Illinois*, 14 DCBA Brief, 10 (2001), available at http://www.dcba.org/brief/janissue/2001/art20101.htm.
3. *Summit Elec Co v Mayrent*, 17 Ill App 3d 545, 308 NE2d 313 (1st D 1974).
4. *Paddington Corp v Foremost Sales Promotions, Inc*, 13 Ill App 3d 170, 300 NE2d 484 (1st D 1973).
5. Supreme Court Rule 133(c).
6. *Wilbur v Potpora*, 123 Ill App 3d 166, 462 NE2d 734 (1st D 1984).
7. 735 ILCS 5/11-103.
8. 735 ILCS 5/11-108, 5/11-110.
9. *Stocker Hinge Mfg Co v Darnell Industries, Inc*, 94 Ill 2d 535, 447 NE2d 288 (1983).
10. *Office Mates 5, North Shore, Inc v Hazen*, 234 Ill App 3d 557, 599 NE2d 1072 (1st D 1992).
11. *Appelbaum v Appelbaum*, 355 Ill App 3d 926, 823 NE2d 1074 (1st D 2005).
12. *Hanchett Paper Co v Melchiorre*, 341 Ill App 3d 345, 351, 792 NE2d 395, 400 (2d D 2003), relying on *Office Mates 5*, 234 Ill App 3d at 567, 599 NE2d at 1079.
13. *Millard Maintenance Service Co v Bernero*, 207 Ill App 3d 736, 743, 566 NE2d 379, 383 (1st D 1990).
14. *The Agency, Inc v Grove*, 362 Ill App 3d 206, 214, 839 NE2d 606, 614 (2d D 2005).
15. *Mohanty v St. John Heart Clinic, SC,* 2006 WL 3741970 (Ill Sup Ct). This case bears careful reading.
16. Kenneth J. Vanko, *"You're Fired! And Don't Forget Your Non-Compete ...": The Enforceability of Restrictive Covenants in Involuntary Discharge Cases*, 1 DePaul Bus & Com LJ 1, pp 1-48 (Fall 2002).
17. *Dam, Snell and Taveirne Ltd v Verchota*, 324 Ill App 3d 146, 754 NE2d 464 (2d D 2001).
18. *Lawrence & Allen, Inc v Cambridge Human Resource Group, Inc*, 292 Ill App 3d 131, 685 NE2d 434 (2d D 1997).
19. Compare *Smith v Burkitt*, 342 Ill App 3d 365, 795 NE2d 385 (5th D 2003) with *Health Professionals Ltd v Johnson*, 339 Ill App 3d 1021, 791 NE2d 1179 (3d D 2003).
20. 765 ILCS 1065/2(d).
21. *Lyle R. Jager Agency, Inc v Steward*, 253 Ill App 3d 631, 625 NE2d 397 (3d D 1993).
22. *Lawrence* at 141, 685 NE2d at 443.
23. Id, but compare *H&M Commercial Driver Leasing, Inc v Fox Valley Containers, Inc*, 209 Ill 2d 52, 805 NE2d 1177 (2004).
24. *Szabo Food Service, Inc v County of Cook*, 160 Ill App 3d 845, 513 NE2d 875 (1st D 1982).
25. *Abbot-Interfast Corp v Harkabus*, 250 Ill App 3d 13, 619 NE2d 1337 (2d D 1993).
26. Gene A. Peterson, *Understanding Illinois Non-competition Agreements and Restrictive Covenants*, 89 Ill Bar J 472 (Sept 2001).
27. *Springfield Rare Coin Galleries v Mileham*, 250 Ill App 3d 922, 620 NE2d 479 (4th D 1993); but see *Hanchett* (cited in note 12).
28. *Hanchett* (cited in note 12).
29. *Appelbaum* (cited in note 11).
30. *McRand, Inc v van Beelen*, 138 Ill App 3d 1045, 486 NE2d 1306 (1st D 1985).
31. Restatement (Second) of Agency, §112.
32. See *International Airport Centers v Citrin*, 455 F3d 749 (7th Cir 2006).
33. 426 F Supp 2d 827 (ND Ill 2006).
34. See *FoodComm International v Barry*, 328 F3d 300 (7th Cir 2003).
35. *Hanchett* (cited in note 12) really explicates what amounts to the duty of loyalty or the lack thereof. See also Stephen M. Arner, *Recent Developments in Civil Litigation Under the Computer Fraud and*

Abuse Act, Commercial & Business Litigation Newsletter, ABA Section of Litigation, Vol 7, No 4 (Summer 2006).
36. *Johnson* (cited in note 19) is an example.
37. *Francorp, Inc v Siebert*, 126 F Supp 2d 543 (ND Ill 2000).
38. See *Unisource Worldwide, Inc v Carrara*, 244 F Supp 2d 977 (CD Ill 2003).
39. Ill S Ct Rule 206.