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Rethinking Restrictive Covenant Enforceability In Ill.

Law360, New York (October 23, 2009) -- In advising against the blind application of legal doctrines, Justice Oliver Wendell Holmes wrote that "[i]t is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV." O.W. Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 469 (1897).

In this spirit, an Illinois appellate court recently re-examined and rejected over 30 years of well-established precedent regarding the enforceability of restrictive covenants.

In doing so, the court either isolated itself from every other Illinois appellate court or took the first step in decreasing the traditional hostility with which Illinois courts treat restrictive covenants.

From the mid-1970s until a few weeks ago, Illinois law in this area was clear: employers seeking to enforce a restrictive covenant first had to establish that the covenant was necessary to protect either confidential information or a near permanent customer relationship — the two recognized "legitimate business interests" sufficient to support a restrictive covenant under Illinois law.

During the last three decades this rule has been recognized and applied by every appellate court in Illinois.

In late September 2009, the Fourth District Court of Appeal in Sunbelt Rentals Inc. v. Ehlers, No. 4-09-0290, 2009 WL 3052369, __ Ill. App. 3d __, __ N.E.2d __, (Ill. App. Ct. Sept. 23, 2009), determined that the "legitimate business interest" test was not supported by any decision of the Illinois Supreme Court.

Accordingly, the Sunbelt court held that, in determining whether a restrictive covenant is enforceable under Illinois law, "[a court] should evaluate only the time-and-territory restrictions contained therein." Id. at *8.

In doing so, the Fourth District Court of Appeals departed from the clearly established case law of all appellate courts in Illinois (and also previous decisions of the Fourth District).

Barring further action by the Illinois Supreme Court, the Sunbelt court's rejection of the "legitimate business interest" test will be one of the primary issues argued in all future restrictive covenant cases in Illinois.

This circuit split within the Illinois appellate court system is emblematic of the flux nationally regarding the enforceability of restrictive covenants, with states moving in different directions.

Practitioners on either side of the issue, whether practicing in Illinois or elsewhere, should review the Sunbelt decision and evaluate the potential applicability of such an argument or similar arguments to their cases.

The Sunbelt Decision

As noted above, for the last 30-plus years, every Illinois appellate court agreed that a threshold inquiry when evaluating the enforceability of a restrictive covenant is whether it is necessary to protect a "legitimate business interest."

Such an interest "exists where: (1) because of the nature of the business, the customers' relationships with the employer are near permanent and the employee would not have had contact with the customers absent the employee's employment; and (2) the employee gained confidential information through his employment that he attempted to use for his own benefit."

Hanchett Paper Co. v. Melchiorre, 341 Ill. App. 3d 345, 351, 792 N.E.2d 395, 400 (Ill. App. Ct. 2003).

This has become known as the "legitimate business interest" test.

The Sunbelt court analyzed Illinois Supreme Court case law from 1896 to the present and concluded that "the Supreme Court of Illinois has never embraced the 'legitimate-business-interest' test[.]" Id. at *5.

The Sunbelt court also concluded that the "legitimate business interest" test is inconsistent with recent Illinois Supreme Court decisions concerning restrictive covenants — specifically, Mohanty v. St. John Heart Clinic, S.C., 225 Ill. 2d 52, 866 N.E.2d 85 (Ill. 2006).

According to the Sunbelt court, the Illinois Supreme Court determined that the restrictive covenants at issue in Mohanty were enforceable solely by analyzing the reasonableness of the time and territory restrictions contained therein.

Sunbelt, 2009 WL 3052369, at *6 (noting that “the [Illinois] [S]upreme [C]ourt made no mention of the ‘legitimate-business-interest’ test, despite over three decades of its use by the appellate court.”).

Based on its review of the law in this area and its conclusion that the Illinois Supreme Court has never endorsed the “legitimate business interest” test, the Sunbelt court held as follows:

"[Illinois] courts at any level, when presented with the issue of whether a restrictive covenant should be enforced, should evaluate only the time-and-territory restrictions contained therein. If the court determines that they are not unreasonable, then the restrictive covenant should be enforced.

"Thus, this court need not engage in an additional discussion regarding the application of the 'legitimate-business-interest' test because that test constitutes nothing more than a judicial gloss incorrectly applied to this area of law by the appellate court." Id. at *8.

Are Cases Involving Medical Professionals Different From Other Cases?

Except for one case from 1896 involving an undertaker, Hursen v. Gavin, 162 Ill. 377, 44 N.E.2d 735 (Ill. 1896), all of the Illinois Supreme Court decisions discussed by the Sunbelt court concern the enforceability of restrictive convenants in the medical professional context.

Mohanty v. St. John Heart Clinic, S.C., 225 Ill. 2d 52, 866 N.E.2d 85 (Ill. 2006) (group of doctors); Cockerill v. Wilson, 51 Ill. 2d 179, 281 N.E.2d 648 (Ill. 1972) (veterinarian); Canfield v. Spear, 44 Ill. 2d 49, 254 N.E.2d 433 (Ill. 1969) (group of doctors); Bauer v. Sawyer, 8 Ill. 2d 351, 134 N.E.2d 329 (Ill. 1956) (doctor); Ryan v. Hamilton, 205 Ill. 191, 68 N.E.2d 781 (Ill. 1903) (doctor).

Other courts that have reviewed these same cases have concluded that the Illinois Supreme Court simply assumes the presence of a legitimate business interest in cases involving medical professionals.

For example, the First District Court of Appeal has held that “the Illinois Supreme Court’s consistent enforcement of such covenants in the medical professional field, where the duration and geography scope is reasonable, demonstrates its recognition that a professional medical practice is a protectable business interest.”

Retina Services, Ltd. v. Garoon, 182 Ill. App. 3d 851, 856, 538 N.E.2d 651, 653 (Ill. App. Ct. 1989).

Justice Steigmann’s unanimous opinion in Sunbelt does not address whether restrictive covenants in the medical professional context are treated differently.

However, in his dissenting opinion in Lifetec (an opinion that reaches the same conclusion as the majority opinion in Sunbelt), Justice Steigmann rejected this notion:

"It makes no sense to place a greater burden on employers of salespeople than on employers of physicians when the enforceability of noncompete covenants is at issue.

"Surely the physician-patient relationship and access to medical care are more societally significant concerns than any concerns related to the relationship between a retailer of medical products and its sales force.

"I find support in this view in Justice Freeman's partial concurrence in Mohanty, where he wrote, 'a strong case exists for abolishing all physician restrictive covenants as being against public policy. However, I agree that this decision is for the General Assembly to make.'"

Lifetec, Inc. v. Edwards, 377 Ill. App. 3d 260, 280, 880 N.E.2d 188, 204 (Ill. App. Ct. 2007) (Steigmann, J. dissenting) (internal citation omitted).

Going forward, whether or not other appellate courts follow Sunbelt may turn on whether those courts agree with Retina Services or Justice Steigmann's dissenting opinion in Lifetec.

Restrictive Covenant Litigation Post-Sunbelt

Like many attorneys who practice in this area, we often advise clients regarding the enforceability of restrictive covenants.

Regardless of whether a client wishes to enforce or invalidate a restrictive covenant, our analysis always starts with the same question: does the client have a legitimate business interest in need of protection?

After addressing that question and analyzing the reasonableness of the applicable time and territory restrictions, we advise the client regarding the likelihood that a court would enforce the covenant.

The Sunbelt decision, however, has injected significant uncertainty into this analysis. Any company or individual seeking to enforce or invalidate a restrictive covenant in Illinois must now ask additional questions:

Is the employer or the employee located within the Fourth District (i.e., central Illinois, including the state capital, Springfield)? If you are seeking to invalidate a covenant, how will you respond to an argument that the court should adopt the holding of Sunbelt?

In arguing this point, you will most likely have to address whether or not a legitimate business interest is presumed to exist in the medical professional context, and whether such a presumption is the reason for the Illinois Supreme Court's silence on this issue.

If the court rejects the “legitimate business interest” test, how confident are you staking your entire case on the reasonableness (or unreasonableness) of the time, activity, and territory restrictions contained in the restrictive covenants?

The Sunbelt decision is also instructive for those practicing in other jurisdictions. Whether a restrictive covenant is supported by a legitimate business interest is a threshold inquiry in many jurisdictions. Are such tests and rules subject to a Sunbelt-style attack?

Another lesson of Sunbelt is the need to stay on top of the law in this area. For example, there are bills pending in the Massachusetts legislature which would significantly alter the legal rules for restrictive covenants in that state and make the enforcement of such agreements more difficult.

In contrast, in the November 2010 general election in Georgia, voters will decide on a proposed amendment to the Georgia Constitution that would make it much easier to enforce restrictive covenants.

The bottom line is that any court that follows Sunbelt is much more likely to enforce a restrictive covenant, because that case eliminates one of the main tools used to invalidate such agreements in Illinois.

If other Illinois appellate courts or the Illinois Supreme Court follow this precedent, Illinois will change from a state traditionally somewhat hostile to restrictive covenants to a state that is much more accepting of them.

--By Peter A. Steinmeyer (pictured) and Jake Schmidt, Epstein Becker & Green PC

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