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Noncompetition Agreements in **Illinois**

How to Draft an Agreement When Buying a Business

Most corporate lawyers know that a noncompetition agreement done in connection with the sale of a business is more likely to be enforced than a noncompetition agreement with a mere employee. In general, such noncompetition agreements can also be more restrictive. This article probes the outer limits of noncompetition agreements done in connection with the sale of a business to determine how far the buyer's lawyer can go in drafting them. Since 1887, there have been 33 reported Illinois cases interpreting noncompetition agreements connected to the sale of a business. Those court decisions provide guidance on how to draft an enforceable business noncompetition agreement.

What a Noncompetition Agreement Does

The seller of a business agrees in a noncompetition agreement not to compete with the buyer of the business after closing and, in some cases, not to solicit customers of the buyer after closing. A noncompetition agreement fulfills an important economic function in the sale of a business; without a noncompetition agreement, the seller of the business has the legal right to compete with the buyer immediately after closing. The normal expectation of the buyer of a business is that the seller will no longer operate the business. A noncompetition agreement is especially important in the sale of a service business. In a service business, such as an accounting firm, the most valuable assets of the business are the professional staff and customer relationships, not the physical assets (such as computers, desks and chairs.). If the seller is permitted to set up a competing business immediately after closing and hire back the same staff, the buyer's expectation of retaining customers and the goodwill of the business will not be met.

Noncompetition agreements are also used with employees, unconnected to the sale of a business. For example, salespeople hired and given a territory and customer base are often prohibited, after employment ends, from competing in that territory and with those customers for some time period. The test for enforceability of an employment noncompetition agreement is harder to meet than for a sale of business noncompetition agreement. The common test applicable to both agreements is that the restriction against competition must be reasonable as to time, geographical area, and scope of prohibited business activity. For sale of business noncompetition agreements, the restriction will be deemed reasonable if it is: (a) necessary in its full extent to protect the purchaser; (b) unoppressive to the seller; and (c) not harmful to the public. *See Smith v. Burkitt*, 795 N.E. 2d 385 (Ill. App. 2003).

Employment noncompetition agreements have to meet a second test, that the employer must have a protectable interest. A protectable interest consists of one of the following: (a) a near permanent relationship with the employee's customers or (b) the existence of customer lists, trade secrets, or other confidential information. *Central Water Works Supply, Inc. v. Fisher,* 608 N.E.2nd 618 (Ill. App. 1993). A stricter test is applied to employment noncompetition agreements because the employee generally lacks bargaining power, unlike the position of the seller of a business. In addition, the employee needs a way to make a living after leaving employment, while the seller of a business usually intends to leave the business entirely and is compensated for such sale.

The single test applicable to business noncompetition agreements has resulted in buyers winning most of these cases. In the 33 Illinois cases issued since 1887, business noncompetition agreements have been held valid in approximately 75% of them. In the past 50 years, since 1956, business noncompetition agreements have been held valid in 83% of them. By comparison, one nationwide survey indicated that approximately 55% of employment noncompetition agreements were enforced in the survey period, 1980-1989.

Definition of Prohibited Acts

Perhaps the most important part of a sale of business noncompetition agreement is to define the acts of competition which are to be prohibited. There are two ways to do this. The most common way is to include a specific description of the business of the seller, such as a statement that the seller may not "own…any funeral home business." *Sheehy v. Sheehy,* 709 N.E. 2d 200, 204. Noncompetition agreements containing such specific descriptions of prohibited acts have been held enforceable on numerous occasions.

The other way to define prohibited acts is to use a generic description, such as a restriction against engaging in "any business competitive with" the buyer. Such generic definitions have been used in fewer cases, and occasionally, the seller has argued that the definition was too vague to be enforceable. The arguments generally have failed.

In the instant case, the covenant restricts the defendants from engaging in "*any business competitive with [the plaintiffs] for a period of five (5) years.*" Contrary to the defendants' assertion, we do not believe that this prohibits the defendants from engaging in "any type of any conceivable business activity there is." Based on the plaintiffs' complaint, the business purchased from the defendants pertained to arts and crafts. If that is the case, then the covenant is certainly not unreasonable or too vague. *Smith*, 795 N.E. 2d at 392.

Illinois courts have upheld other similar generic descriptions of

prohibited acts. Courts have even upheld restrictions which prevent a selling shareholder from competing in any business owned by the buyer (including businesses unrelated to the business which was sold). *Stamatakis Indus., Inc. v. King*, 520 N.E.2d 770, 775 (Ill. App. 1987).

Time Limitations

While a number of secondary sources recommend that a business noncompetition agreement have a time limitation of no more than three years, many Illinois cases have enforced longer time limitations. The most common period was five years (seven of the 33 cases noted above). Some Illinois courts have found business noncompetition agreements with 10-year restrictions to be enforceable.

Time restrictions of 10 years and more make it increasingly unlikely that the business noncompetition agreement will be enforced.

The cases do not provide a clear rationale for enforcing or not enforcing particular time restrictions, other than to state that a restriction is either "reasonable" or "unreasonable" in light of the circumstances of the particular case. Courts also state that the time restriction must be necessary in its full extent for protection of the buyer, but must at the same time not be oppressive to the seller, and not be injurious to the interests of the general public. In evaluating a restriction against soliciting clients, courts have considered how long it takes to develop a client and how long the target business had been in operation. One court has said that the restriction should last "only as long as the good will transferred lasts," meaning as long as necessary to prevent the seller from drawing away customers if the seller were to re-enter the same business in the restricted territory.

Geographic Limitations

Most Illinois cases enforcing business noncompetition agreements have relatively limited geographic limitations, generally consisting of a radius measurement or the boundaries of a municipality or a county. Some agreements have successfully defined

the geographic limitation in a generic way such as "any locality where the seller would be brought into direct competition with the buyer."

Courts apply the same standard to judge the geographic limitation as to test the time limitation: the geographic limitation must be necessary in its full extent for protection of the buyer, but must at the same time not be oppressive to the seller, and not be injurious to the interests of the general public.

Courts reason that if the prohibited geographic area is the same area in which the seller had been doing business, the geographic limitation is reasonable and will be enforced. Other courts are willing to approve a geographic area in which the business might be reasonably expected to extend during the time period of the noncompetition agreement.

Some courts have also considered the presence or absence of competing businesses in the area; if there were other competing businesses available to serve the public, then prohibiting the seller from operating in the area will not harm the public. Courts tend to enforce geographic limitations if the seller still has an area in which the seller can compete to earn a livelihood.

In most cases, a geographic limitation greater than a single municipality or a single county has been held to make the noncompetition agreement unenforceable.

Interaction of Time and Geographic Limitations

Courts in Illinois consider both the time and geographic limitations in determining whether to enforce business noncompetition agreements. An agreement with a longer time limit can be enforced, so long as the geographic limit is relatively small; conversely, an agreement with a large geographic limitation might be enforced, so long as the time limitation was relatively small.

In a number of Illinois decisions, such combinations have resulted in the courts upholding the noncompetition agreements. On the other hand, if the business noncompetition agreement contains both a long time limit, and an expansive geographic limitation, it is likely to be stricken.

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Nonsolicitation

Courts are more likely to enforce nonsolicitation promises than noncompetition promises. A nonsolicitation promise is a prohibition against soliciting customers of the buyer. Courts have classified nonsolicitation promises as "activity restraints," which, rather than prohibiting all competition within a particular geographic area, simply prohibit a type of activity. The restriction is often a prohibition on soliciting or accepting business from customers of the target business. Such activity restraints are subject to a less stringent test of reasonableness than that which is applied to restrictions with a geographical limitation. In fact, courts have enforced nonsolicitation restrictions which have no geographical limitation, prohibiting the seller from soliciting or accepting business from the target businesses customers anywhere they are located in the world. Seven known reported Illinois cases deal with nonsolicitation promises, and in all of them, the noncompetition agreement was held to be valid.

Court Modification

Court modification of noncompetition agreements, also known as "blue penciling," has always been the subject of confusion and disagreement among Illinois courts. The Supreme Court of Illinois, in a case dealing with an employment noncompetition agreement, said that it would not hold that a court of equity may never modify a noncompetition agreement; the fairness of the restraint initially imposed must be a relevant consideration to a court of equity. The implication is that an unfair noncompetition agreement would not be modified by a court, but instead would be rejected in full as unenforceable. Two Illinois cases have relied on that decision to hold that a business noncompetition agreement could not be modified to create a shorter time limitation or smaller geographic limitation. *Boyar-Schultz Corp. v. Tomasek,* 418 N.E. 2d 911, 914 (Ill. App. 1981) (court refused to modify geographic area consisting of United States and Canada, to a nonsolicitation restriction only); *Central Specialties Co. v. Schaefer*, 318 F. Supp. 855, 859 (N.D. Ill. 1970) (court refused to modify a noncom-

Case name	Business	Time Limit	Geographical Limit
Smith	Doll manufacturing	5 years	Franklin County
Weitekamp	Refrigeration Service	10 years, modified to 4 years	300-mile radius, modified to 1 county
Russell	Trucking	10 years	100-mile radius
SSA Foods	Restaurant	5 years	Cook County
O'Sullivan	Optometrist	5 years	75-mile radius
Vendo	Manufacture Vending Machines	5 years individual, 10 years corporation	Territory in which the buyer does business
Bauer	Physicians	5 years	25-mile radius
Decker	Plumbing and Heating	5 years	Any locality where the seller would be brought into direct competition with buyer
Pelc	Grocery Store and Meat Market	None	2-block radius
Watson	Photographer	For so long as the buyer is in the business	Chicago
Frazer	Manufacture Axle Grease	None	None

Case name	Business	Time Limit	Geographical Limit
Sheehy	Funeral Home	4 years	10-mile radius
Diepholz	Car Dealership	4 years	Coles County
Jackson	Hobby Shop	2 years	30-mile radius
Health	Healthcare services to jails	3 years	Illinois and Wisconsin
Hamer II	Real Estate Management	3 years	75-mile radius
Central Water	Plumbing Supplies	3 years	In the geographic area in which the company is then doing business
Howard	Actuarial Firm	3 years, but if violated, automatic 3 year extension	None, but nonsolicitation only
Decker, Berta	Accounting Firm	3 years	35-mile radius
Hamer I	Real Estate Management	3 years	75-mile radius
Stamatakis	Graphic Arts	2 years	1,000-mile radius
Talmadge	Accounting Firm	1 year	None, but 1 year, limited to current claims
General	Car Bumper Repair	1 year	Chicago Metro Area

petition agreement lacking a geographic limit). *See also Arcor, Inc. v. Haas*, 842 N.E. 2d 265, 274 (Ill. App. 2005) (dicta stating that modification would be refused if the degree of unreasonableness of a noncompetition agreement renders it unfair).

More recent Illinois cases, however, have permitted blue penciling. In *Weitekamp v. Lane,* the trial judge cut the time limitation from 10 years to 4 years, and a geographic limitation from a 300 mile radius to one county. The Illinois Appellate Court approved:

> The parties themselves provided for modification by including in the covenant a provision that if the covenant were determined to exceed the appropriate time or geographic scope it "shall be reformed to the maximum time or geographic limitations permitted by the applicable laws." A court may modify the restraints embodied in a covenant not to compete.

Weitekamp v. Lane, 620 N.E. 2d 454, 461 (Ill. App. 1993).

Note that in *Weitekamp,* the noncompetition agreement itself gave the court the authority to modify it. Such a power is not automatically allowed, but must be bestowed by the agreement.

Drafting Tips

Perhaps the most important lesson to be learned from these Illinois cases is that the buyer should take what it needs to protect its new business, not what can be negotiated. Remember that the standard for reasonableness for business noncompetition agreements in Illinois is that they must be (a) necessary in their full extent to protect the purchasers; (b) unoppressive to the seller; and (c) not harmful to the public. A noncompetition agreement which goes beyond what is necessary to protect the purchaser will likely be stricken.

Specific definitions of prohibited acts are most often used, but a generic definition (such as "competing with the buyer") has been held to be enforceable. If it is difficult to come up with a definition for the buyer's business, perhaps because the buyer is in several businesses, a generic definition may be useful. Generic definitions have included businesses then owned by the buyer, even if they were unrelated to the business which was sold.

A time limit must always be included in a business noncompetition agreement. There are no recent cases upholding either a noncompetition agreement without a time limit, or with an open-ended time

Case name	Business	Time Limit	Geographical Limit
Arcor	Metal Fabricator	3 years	None
Marathon	Gas Stations	10 years	Illinois, St. Louis, Rock County, WI
Boyar-Schultz	Coil Processing Equipment	5 years	US and Canada
Central Specialities	Manufacture Clothes Hangers	5 years	None
McCook	Manufacture Windows	For so long as buyer is engaged in the business	150-mile radius
Parish	Manufacturer of Barrel Components	16 years	US east of Mississippi or any territory in which the buyer is selling products
Tarr	Dentist	None	25-mile radius
Union	Strawboard Manufacturer	25 years	Illinois and anywhere where doing so will conflict with the business of buyer
Lanzit	Paper Box Manfacturer	10 years	Illinois, Indiana

limit, such as "for so long as the buyer is in business."

The time limit should equal the time necessary for the buyer to establish customer and business relationships in the target business.

A geographic limit smaller than the State of Illinois is more likely to be upheld. Geographic limits consisting of the State of Illinois or the entire United States have been allowed, though there are relatively few recent cases on limits that large. Generic geographic limits, such as the "territory in which the buyer is doing business" have been upheld, but it will be necessary to show that the seller could determine the extent of that limit. The geographic limit should be equal to the area currently served by the buyer, or the area to which the buyer can reasonably expand.

Nonsolicitation promises are likely to be enforced by courts, so it is wise to add a nonsolicitation promise. A noncompetition agreement consisting only of a nonsolicitation promise with no geographic limit has been upheld.

It is a good idea to also have a severability clause to allow for partial enforcement of the noncompetition agreement.

A business noncompetition agreement should include a provision authorizing the court to modify the noncompetition agreement if it is held to be unenforceable. Since Illinois law is in conflict on this point, be aware that the court may not necessarily follow the provision, so it is best to keep the noncompetition agreement terms reasonable in any case.

With these drafting tips and considerations, the lawyer should be better able to draft an enforceable non-compete agreement. ■

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