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Consulting Room

Should I Stay or Should I Go?

The question on the lips of every entrepreneur faced with a restrictive employment covenant.

By Brian J. Hunt

You've been planning for quite some time. You've formulated your business plan, chosen your organizational form and made preliminary personnel decisions. You're prepared to start your own business. You suspect your employer won't be pleased, but does he/she have the right to stop you?

Whether in technology, manufacturing or service, an entrepreneur must consider whether his or her new business will violate a restrictive employment covenant—a document employers are using with increasing frequency.

This document most often takes the form of a covenant not to compete and typically includes terms designed to prevent the individual from working in a particular industry or a particular geographic area for a specified period of time. The entrepreneur bound by such a covenant must consider whether its terms will impair his/her ability to pursue the new business.

The basic test applied by Illinois courts in these cases is to ask whether the covenant is reasonably necessary to protect the employer from improper or unfair competition. In making this determination, the courts consider the employer's need to protect a legitimate business interest, the hardship to the former employee, the likely injury to the public, and the overall reasonableness of the restrictive covenant with respect to time, geography and activity limitations.

There are two general situations in which a legitimate business interest exists: (1) where the customer relationships are near permanent and, if not for his or her

association with the employer, the former employee would not have had contact with the customers; and (2) where the former employee acquired trade secrets or other confidential information through his/her employment, and subsequently tried to use this information for his/her own benefit. Naturally, the determination varies according to the facts and circumstances of each case.

Although courts do frown upon restrictive covenants, they are enforced in certain circumstances. In a 2001 case involving an accounting practice (*Dam, Snell & Taveirne, Ltd. v. Verchota*), the defendant Miller, an unlicensed accountant hired by Dam, Snell & Taveirne (DST), agreed to sign an employment agreement containing a restrictive covenant at the time of her hiring in May 1994. Prior to joining DST, Miller had owned her own accounting business, with approximately 25 business clients and 40 to 50 individual clients, most of which joined her at DST. The covenant Miller executed provided, in relevant part, that: "In the event of termination of this agreement by either party, the Employee agrees that he/she shall not, either directly or indirectly, in a professional capacity as an individual, a partner of another firm, or as an employee of another individual or firm, for a period of two (2) years after such termination, perform any accounting services as a public accountant for any person, firm or corporation, which is on the Employer's client list at the time of the Employee's termination. This provision also applies to the clients of any predecessor firm that has since merged or been acquired by the Employer."

Miller's services included bookkeeping, payroll, computer training, preparing corporate and individual tax returns, and installing rudimentary accounting systems.

During her employment with the firm, Miller became romantically involved with Verchota, then a firm principal. On August 1, 2000, Verchota, who was not bound by a restrictive covenant, terminated his employment with DST to begin his own practice, and took many DST clients with him. On August 4, 2002 Miller advised DST that she was resigning effective August 18. On August 10, 2000 Verchota sent a list of approximately 100 clients that were transferring their business to the new firm, and advised DST that they should be removed immediately from their client list.

During the 14-day interval between her notice date and her planned termination date, Miller worked a total of 3 hours, which she claimed was due to an injury. Miller began working at the offices of Miller-Verchota (in which she owned a 30-percent interest) on August 21, 2000. She then began working for former DST clients.

DST filed suit to enforce the restrictive covenant. Miller testified that she had not decided to leave DST until August 4, the date upon which she proffered her notice. Miller argued that her new firm's clients were not on DST's client list at the time of her termination because they had become Verchota's clients.

A current principal of DST testified that the firm had developed proprietary and standardized methods for handling its tax clients, including billing techniques, clients' job sheets and acceptance sheets, which were made available to Miller through her employment. They stated that one of the purposes of the restrictive covenant was to protect DST's client lists and marketing materials. The DST principal also testified that the average longevity of DST's clients was substantial, and that the revenue received from particular clients often increased as the clients

became more comfortable utilizing its services. The DST principal further testified that DST had spent approximately $190 thousand in marketing efforts to develop clientele for the office in which Miller had worked.

Enforcing the restrictive covenant, the court concluded that Miller's testimony was "incredible." The court also noted that accountants often have lengthy business relationships with their clients, and that DST had a near-permanent relationship with its clients, in which it had made significant investment and had a legitimate, protectable interest.

Reviewing the DST decision, the legal practitioner hardly can help but wonder how the outcome might have been different. For instance, would the language of the restrictive covenant have been construed against Miller if she had continued to work at DST for a longer period after Verchota's departure? Similarly, what if Miller had made a strong good-faith work effort between her notice and her termination date? Surely Miller's cause was not furthered by the court's determination that her testimony was "incredible."

Unfortunately, these queries remain imponderables, and Miller is precluded from providing accounting services to her former employer's clients.

Restrictive covenants can stop or, at the very least, slow the entrepreneur's progress in starting up a new business venture. The wise entrepreneur therefore knows that an ounce of prevention is worth more than a pound of cure.

About the Author
Brian J. Hunt is the managing member of The Hunt Law Group, LLC, Chicago, Ill., and a member of the Defense Research Institute's Professional Liability Committee. His practice focuses on the counseling and representation of CPAs and other business professionals and on the resolution of business disputes. Brian was selected in 2005, 2006 and 2007 as an Illinois Super Lawyer in Business Litigation. He can be reached at 312.384.2300 or ***bhunt@hunt-lawgroup.com****.*