

12S

Restrictive Covenants, Trade Secret Misappropriation, and Fiduciary Duties

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II. [12S.2] RESTRICTIVE COVENANTS

In the first sentence in the second paragraph, “restrictice coevants” should read “restrictive covenants.”

Add after the first sentence in the second paragraph and its accompanying citations:

But see H&M Commercial Driver Leasing, Inc. v. Fox Valley Containers, Inc., 209 Ill.2d 52, 805 N.E.2d 1177, 282 Ill.Dec. 160 (2004) (finding provision that restricted one employer’s ability to hire former employees of another company to be restraint on trade rather than covenant not to compete or restrictive covenant).

Add at the end of the second paragraph:

See also Grand Vehicle Works Holdings Corp. v. Frey, No. 03 C 7948, 2005 U.S. Dist. LEXIS 9509 (N.D.Ill. May 11, 2005) (refusing to enforce non-compete agreement for lack of protectable interest and narrow tailoring even when parties agreed that it was enforceable).

C. Reasonableness

3. [12S.8] Reasonableness of Temporal Scope

Add at the end of the first paragraph:

See also Hay Group, Inc. v. Bassick, No. 02 C 8194, 2005 U.S. Dist. LEXIS 22095 (N.D.Ill. Sept. 29, 2005) (finding non-compete agreement that prohibited employee from engaging in any type of competition with employer for two-year period unreasonable as matter of law).

4. [12S.9] Reasonableness of Geographic Scope

Add at the end of the section:

Courts also have upheld covenants that contain no geographical restriction when the covenant prohibited only solicitation of customers with whom the employee had material contact. *See YCA, LLC v. Berry, No 03 C 3116, 2004 U.S. Dist. LEXIS 8129 (N.D.Ill. May 7, 2004).* See §12.10 for a more detailed discussion of these types of covenants, known as “activity restraints.”

E. [12S.14] Termination Without Cause and Employer Breach

Add at the end of the second paragraph:

Restrictive covenants will be enforced, however, when an employee is terminated for cause. *See Diamond Blade Warehouse, Inc. v. Paramount Diamond Tools, Inc., 420 F.Supp.2d 866, 870 – 871 (N.D.Ill. 2006).*

III. INTERPRETATION OF RESTRICTIVE COVENANTS

B. [12S.16] Judicial Modification: “Blue Pencil” Doctrine

Add after the third sentence in the last paragraph and its accompanying citations:

See also *Hay Group, Inc. v. Bassick*, No. 02 C 8194, 2005 U.S. Dist. LEXIS 22095 (N.D.Ill. Sept. 29, 2005) (refusing to modify agreement, even in presence of severability clause, when restraint was sufficiently overbroad that any modifications would amount to court rewriting agreement).

IV. SPECIFIC CATEGORIES OF RESTRICTIVE COVENANTS

D. Injury to Public: Attorney and Physician Specific Covenants

2. [12S.22] Medicine

Add at the end of the next-to-last paragraph:

The First District also disagreed with the Fifth Circuit’s holding in *Mohanty v. St. John Heart Clinic*, 358 Ill.App.3d 902, 832 N.E.2d 940, 295 Ill.Dec. 490 (1st Dist. 2005), *appeal granted*, 2006 Ill. LEXIS 2 (Jan. 11, 2006), in which the court refused to invalidate a restrictive covenant in a physician’s employment contract. The *Mohanty* court concluded that the agreement “restricting the plaintiffs from practicing medicine [would] not cause undue hardship to the plaintiffs” and that it was not overly broad or unreasonable. 832 N.E.2d at 945. The court further stated that “any change as to the enforceability of such covenants is for our supreme court or the legislature” to address. 832 N.E.2d at 947.

V. [12S.23] TRADE SECRETS MISAPPROPRIATION

The list at the top of p. 12-21 is revised:

Trade secret misappropriation consists of three elements:

- a. the existence of a “trade secret” (not generally known in the industry);
- b. “misappropriation” of the trade secret (“[M]isappropriation means stolen ‘rather than developed independently or obtained from a third source.’” *Kim v. Dawn Food Products, Inc.*, No. 04 C 8141, 2006 U.S. Dist. LEXIS 11033, *7(N.D.Ill. Mar. 17, 2006), quoting *Composite Marine Propellers, Inc. v. Van Der Woude*, 962 F.2d 1263, 1266 (7th Cir. 1992)); and
- c. the defendant’s use of the trade secret in its business (“Use” is a broad concept. As one court has stated “[t]he idea of ‘use’ as embodied in this language indicates that the third party’s actions have to be improper and

damage the owner of the secret to some extent.” *Cognis Corp. v. Chemcentral Corp.*, 430 F.Supp.2d 806, 812 (N.D.Ill. 2006)).

Learning Curve Toys, Inc. v. PlayWood Toys, Inc., 342 F.3d 714, 721 (7th Cir. 2003); *Lucini Italia Co. v. Grappolini*, No. 01 C 6405, 2003 U.S. Dist. LEXIS 7134, *46 (N.D.Ill. Apr. 24, 2003); *David White Instruments, LLC v. TLZ, Inc.*, No. 02 C 7156, 2003 U.S. Dist. LEXIS 331, *11 (N.D.Ill. Jan. 6, 2003).

A. What Is a “Trade Secret”?

1. [12S.24] Definition Under Illinois Trade Secrets Act

The Compuware citation in the last paragraph is revised:

See *Compuware Corp. v. Health Care Service Corp.*, 203 F.Supp.2d 952 (2002) (holding ITSA inapplicable because company failed to preserve confidentiality of product), *op. withdrawn*, No. 01 C 0873, 2002 U.S. Dist. LEXIS 25684 (N.D.Ill. Oct. 31, 2002) (district court withdrew previous opinion because parties settled).

3. [12S.26] Cases Regarding Existence of Trade Secret

Add at the end of item b:

a recent line of cases from the First and Second Districts appears to require that an employer safeguard its customer information by limiting access to both printed and computer-stored copies of the information and further requires employees to sign confidentiality agreements before a court will find trade secret status; see *Liebert Corp. v. Mazur*, 357 Ill.App.3d 265, 827 N.E.2d 909, 293 Ill.Dec. 28 (1st Dist. 2005) (customer information did not constitute trade secret when employer failed to take steps to restrict physical copies of information and employees did not sign confidentiality agreements); *Multiut Corp. v. Draiman*, 359 Ill.App.3d 527, 834 N.E.2d 43, 295 Ill.Dec. 818 (1st Dist. 2005) (customer information constituted trade secret when employer safeguarded electronic and printed copies of information and required confidentiality agreements); *Arcor, Inc. v. Haas*, 363 Ill.App.3d 396, 842 N.E.2d 265, 299 Ill.Dec. 526 (1st Dist. 2005) (customer information did not constitute trade secret when only security measure employer took was to have employees sign confidentiality agreements); *The Agency, Inc. v. Grove*, 362 Ill.App.3d 206, 839 N.E.2d 606, 298 Ill.Dec. 283 (2d Dist. 2005) (customer information constituted trade secret when employees signed confidentiality agreements and employer protected electronic information with password and kept physical copies in file cabinet with limited access); *but see Computer Associates International v. Quest Software, Inc.*, 333 F.Supp.2d 688, 696 (N.D.Ill. 2004) (“the ITSA requires only reasonable measures, not perfection”);

Add at the end of item g:

Fisher Investments, Inc. v. Carlson, No 04 C 6619, 2004 U.S. Dist. LEXIS 22060 (N.D.Ill. Nov. 2, 2004) (list of clients and potential clients does not constitute trade secret without showing of great time and expense spent

compiling list and reasonable efforts to maintain secrecy of list once compiled).

B. What Is “Misappropriation”?

4. [12S.30] “Inevitable Disclosure” Doctrine

Add at the end of the section:

For a more recent discussion on the doctrine of inevitable disclosure, see Elizabeth A. Rowe, *When Trade Secrets Become Shackles: Fairness and the Inevitable Disclosure Doctrine*, 7 Tul.J.Tech. & Intell.Prop. 167 (2005).

C. [12S.31] Remedial Scheme of Illinois Trade Secrets Act

Add at the beginning of the section:

As a preliminary matter, application of the ITSA is not limited to Illinois residents. It may be applied to nonresident defendants. *Concept Innovation v. CFM Corp.*, No. 04 C 3345, 2005 WL 670637, *3 (N.D.Ill. Mar. 21, 2005).

The Hecny Transportation citation near the beginning of the first paragraph on p. 12-29 is revised:

See *Hecny Transportation, Inc. v. Chu*, No. 98 C 7335, 2004 U.S. Dist. LEXIS 5417, *6 (N.D.Ill. Mar. 30, 2004) (“ITSA abolished all common law causes of action for misuse of trade secrets except for breach of contract claims”), *aff’d in part, vacated in part*, 430 F.3d 402, 404 (7th Cir. 2005) (“This statute abolishes claims other than those based on contract arising from misappropriated trade secrets, replacing them with claims under the Act itself.”);

Add at the end of the section:

Recently, the Seventh Circuit narrowly construed the ITSA’s preemptive effect, finding it barred only claims dependent on the misappropriation of a trade secret. *Hecny Transportation, supra*, 430 F.2d at 405 (“An assertion of trade secret in a customer list does not wipe out claims of theft, fraud, and breach of the duty of loyalty that would be sound even if the customer list were a public record.”). See also *Dominion Nutrition, Inc. v. Cesca*, No. 04 C 4902, 2006 U.S. Dist. LEXIS 15515 (N.D.Ill. Mar. 2, 2006) (refusing to bar breach of fiduciary duty and interference with business expectancy claims). In doing so, the Seventh Circuit relied on a comment to the Uniform Trade Secrets Act of 1985, on which the ITSA is based, that “[t]he [provision] does not apply to duties imposed by law that are not dependent upon the existence of competitively significant secret information, like an agent’s duty of loyalty to his or her principal.” *Hecny Transportation*, 430 F.3d at 405, quoting the Comments to the Uniform Trade Secrets Act of 1985. See also *Systems America, Inc. v. Providential Bancorp, Ltd.*, No. 05 C 2161, 2006 U.S. Dist. LEXIS 6996 (N.D.Ill. Feb. 24, 2006); *C.H. Robinson Worldwide, Inc. v. Command Transportation, LLC*, No. 05 C 3401, 2005 U.S. Dist. LEXIS 28063 (N.D.Ill. Nov. 16, 2005).

Based on the Seventh Circuit's decision in *Hecny*, it may be difficult to resolve conflicting claims with a motion to dismiss in federal court. See *FAIP North America, Inc. v. Sistema s.r.l.*, No. 05 C 4002, 2005 U.S. Dist. LEXIS 32798 (N.D.Ill. Dec. 14, 2005) (in order to assess a motion to dismiss, court must consider only whether allegations claim that each count is based solely on the misappropriation of trade secrets or on wrongdoing of a different sort). *But see Systems America, Inc., supra* (dismissing conversion claim based solely on defendants' alleged misappropriation of trade secret).

VI. [12S.32] FIDUCIARY DUTIES

Add at the end of the first paragraph:

Dominion Nutrition, Inc. v. Cesca, No. 04 C 4902, 2006 U.S. Dist. LEXIS 15515, **27 – 28 (N.D.Ill. Mar. 2, 2006) (“a fiduciary is estopped from denying that the opportunity he or she developed belongs to the corporation if the fiduciary failed to first offer the opportunity to the corporation and used corporate assets to develop the opportunity”); *Baldi v. Lynch (In re McCook Metals, L.L.C.)*, 319 B.R. 570, 596 (Bankr. N.D.Ill. 2005) (“When a corporation’s fiduciaries actually use corporate assets to pursue a business opportunity, they implicitly assert that the project constitutes a corporate opportunity, and therefore, ‘the fiduciary is estopped from denying that the resulting opportunity belongs to the corporation.’ ”), quoting *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 643 N.E.2d 1206, 1217, 205 Ill.Dec. 599 (1st Dist. 1994).

A. [12S.33] Corporate Officers, Directors, and Employees

Add at the end of the second paragraph:

Illinois law on this subject, however, is not entirely consistent. As one court has stated, “Illinois law involving fiduciary duties of corporate officers following their departure from a corporation is, at best, confusing, and this includes the definition of who is an ‘officer’ for purposes of ascribing fiduciary responsibility.” *Hay Group, Inc. v. Bassick*, No. 02 C 8194, 2005 U.S. Dist. LEXIS 22095, *30 (N.D.Ill. Sept. 29, 2005). “A person may owe fiduciary duties equal to those owed by a corporate officer even when that individual does not possess a corporate title.” *Exhibit Works, Inc. v. Inspired Exhibits, Inc.*, No. 05 C 5090, 2005 U.S. Dist. LEXIS 34909, *9 (N.D.Ill. Dec. 21, 2005). “A ‘defacto’ corporate officer status can be created if the individual was (1) substantially intertwined with the business’ operations, (2) held himself out as a corporate officer, or (3) has previously exercised corporate powers.” *Id.*

Add after the second sentence in the fourth paragraph:

See also *Diamond Blade Warehouse, Inc. v. Paramount Diamond Tools, Inc.*, 420 F.Supp.2d 866 (N.D.Ill. 2006) (finding highly paid employee who had access to confidential information breached fiduciary duty when he solicited former employer’s customers and employees).

Add at the end of the section:

The court in *Beltran v. Brentwood North Healthcare Center, LLC*, 426 F.Supp.2d 827, 832 (N.D.Ill. 2006), refused to extend a breach of the fiduciary duty of loyalty to an employee who falls asleep on the job. According to the court, “sleeping on the job, like other forms of negligent or substandard job performance, is inherently dissimilar from the types of self-dealing scenarios that courts have recognized as forming the basis for viable breach-of-fiduciary-duty claims.” *Id.*

C. [12S.35] Members and Managers of Limited Liability Companies

Add at the end of the third paragraph:

Recently, the First District refused to impose fiduciary obligations on a member in a manager-managed company when the member did not have managerial authority under the operating agreement. *Katris v. Carroll*, 362 Ill.App.3d 1140, 842 N.E.2d 221, 299 Ill.Dec. 482 (1st Dist. 2005). The court reached this conclusion despite the contention that the member exercised some of the authority of a manager in his capacity as director of technology for the LLC.

VIII. POSSIBLE RELATED CLAIMS

D. [12S.44] Tortious Interference with Prospective Economic Advantage

The Doherty citation is revised:

Doherty v. Kahn, 289 Ill.App.3d 544, 682 N.E.2d 163, 224 Ill.Dec. 602 (1st Dist. 1997), *abrogated on other grounds by Soh v. Target Marketing Systems, Inc.*, 353 Ill.App.3d 126, 817 N.E.2d 1105, 288 Ill.Dec. 455 (1st Dist. 2004).

J. [12S.50] Defamation

The Doherty citation is revised:

Doherty v. Kahn, 289 Ill.App.3d 544, 682 N.E.2d 163, 224 Ill.Dec. 602 (1st Dist. 1997), *abrogated on other grounds by Soh v. Target Marketing Systems, Inc.*, 353 Ill.App.3d 126, 817 N.E.2d 1105, 288 Ill.Dec. 455 (1st Dist. 2004).

L. [12S.52] Conspiracy

Add at the end of the paragraph:

Do It Best Corp. v. Passport Software, Inc., No. 01 C 7674, 2005 U.S. Dist. LEXIS 7213 (N.D.Ill. Mar. 31, 2005) (finding civil conspiracy claim preempted by federal copyright law).