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APRIL 2008

THE COURTHOUSE PERSONNEL DEPARTMENT

A MATERIAL BREACH OF AN EMPLOYMENT CONTRACT

WILL NULLIFY A COVENANT NOT TO COMPETE

In the February 2008 issue of this publication we advised employers and employees that, in a recent Illinois Appellate Court decision, the Court concluded that only reasonable time and territory restrictions imposed by employers need be evaluated in determining the enforceability of restrictive covenants in employment contracts and manuals. The Court opened the door for the Illinois Supreme Court to clarify that any other subjective consideration, such as, the employee's use of the employer's confidential information for his own benefit or the near-permanent nature of the employer's relationship with the customer (collectively referred to herein as the "legitimate business interest"), was not relevant.

Should the Supreme Court sanction this more objective analysis, whether restrictive covenants should be enforced should be easier to determine. That is, provided, of course, the employer hasn't already breached its obligation to the employee, thereby nullifying the restrictive covenant. This concept is illustrated by the recent Illinois case of *Virendra S. Bisla, M.D., Ltd. v. Akhtar Parvaiz*.

In this case, Dr. Bisla ("Bisla") operated an Illinois medical corporation under his own name (the "Bisla Corporation"). Dr. Parvaiz ("Parvaiz") was a cardiologist. Bisla presented Parvaiz with a written employment agreement that consisted of a base salary and, after three years of employment, assuming Parvaiz satisfied certain criteria, Parvaiz would have an opportunity to purchase a 50% equity interest in Bisla Corporation. The employment agreement provided that Bisla would carry malpractice insurance for Parvaiz in Indiana and medical coverage for Parvaiz and his family. The employment agreement also included a non-competition covenant the prohibited Parvaiz from practicing medicine within a 10-mile radius of Bisla Corporation for 12 months after the termination of the agreement.

Section 15 of the Employment Agreement, entitled "Equity Interest," provided as follows:

Equity Interest. In the event Employee completes three (3) full years of employment with Corporation and satisfies each of the following conditions, Employee shall be offered the option to acquire an equity interest in Corporation equal to the equity interest of each other stockholder of Corporation. The determination as to whether Employee has satisfied Subsection (b) shall be

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solely determined by Corporation.

(a) Employee shall not have given or received notice of termination of his employment at or prior to the date of closing of the purchase of stock by Employee.

(b) Employee shall have demonstrated:

(1) continuous compatibility with other physician employees and professional staff of Corporation;

(2) acceptance by patients; and

(3) above-average professional performance.

(c) A final purchase agreement shall be entered into by the parties setting forth the purchase price and terms and conditions for the acquisition of such equity interest.”

Parvaiz completed three years employment with Bisla Corporation, fulfilling the objective and subjective criteria of section 15. Bisla, however, failed to offer Dr. Parvaiz the option to acquire a 50% equity interest as agreed, but instead offered a 45% interest over a 5-year period. Bisla also failed to provide Parvaiz and his family with medical insurance and with malpractice coverage in Indiana as agreed. Parvaiz then established his own medical practice within the 10-mile radius. Bisla filed a complaint for injunctive relief to prevent Parvaiz from practicing medicine within the 10-mile radius.

The court denied the injunction on the grounds that, among other things, Bisla’s failure to offer Dr. Parvaiz a 50% equity interest constituted a material breach of the employment agreement, thereby invalidating the covenant not to compete.

The court stated that a breach of contract can operate to discharge the duties of a covenant not to compete where the breach is material. Whether a breach is material involves a determination of “whether the breach worked to defeat the bargained for objective of the parties or caused disproportionate prejudice to the non-breaching party, whether custom and usage consider[] such a breach to be material, and whether the allowance of reciprocal non-performance by the nonbreaching party will result in his accrual of an unreasonable or unfair advantage.”

The lesson for employers is that they must be certain that they have not violated employment agreements or policies that may render covenants not to compete and other key employment provisions, such as confidentiality clauses, unenforceable. This is critically important for employers in view of the fact that, as stated in the February 2008 issue of this publication, the employer may no longer be able to successfully assert the legitimate business interest argument to employee challenges to covenants not to compete.

Please do not hesitate to contact us if you have a question about any of the issues discussed in this publication.

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