

LEGALLY SPEAKING

Restrictions on competition after termination of representation agreement



by Gerald M. Newman
ERA General Counsel

In many commercial relationships, one of the parties may have to reveal information about its business to the other. For example, a principal may disclose information about its engineering processes to its sales representative so that the rep will know whether the principal is capable of manufacturing products that will fulfill the customers' specifications. Likewise, the principal may reveal information about its production cost so that the rep will know how far he or she can go in negotiating price concessions. Also, a principal who hires a new rep to take over an established sales territory may reveal customer names and buying habits to the new rep. In addition, the principals may introduce the rep to the largest customers and direct customers' inquiries to the rep so that the customers will look to the rep, rather than the principal, as their contact for sales information.

All of this is quite natural as long as the principal and the sales representative maintain their relationship. Once the representation agreement is terminated, however, the principal may wish to restrict the representative's use of the information and customer relationship that the rep acquired while the agreement was still in effect. In practice, the most effective way for the principal to do this is to include a provision in the representation agreement that will restrict the rep's rights to represent competing principals (or start his or her own competitive business) after the termination. Such restrictions on competition come within the class of contract provisions commonly known as "restrictive covenants."

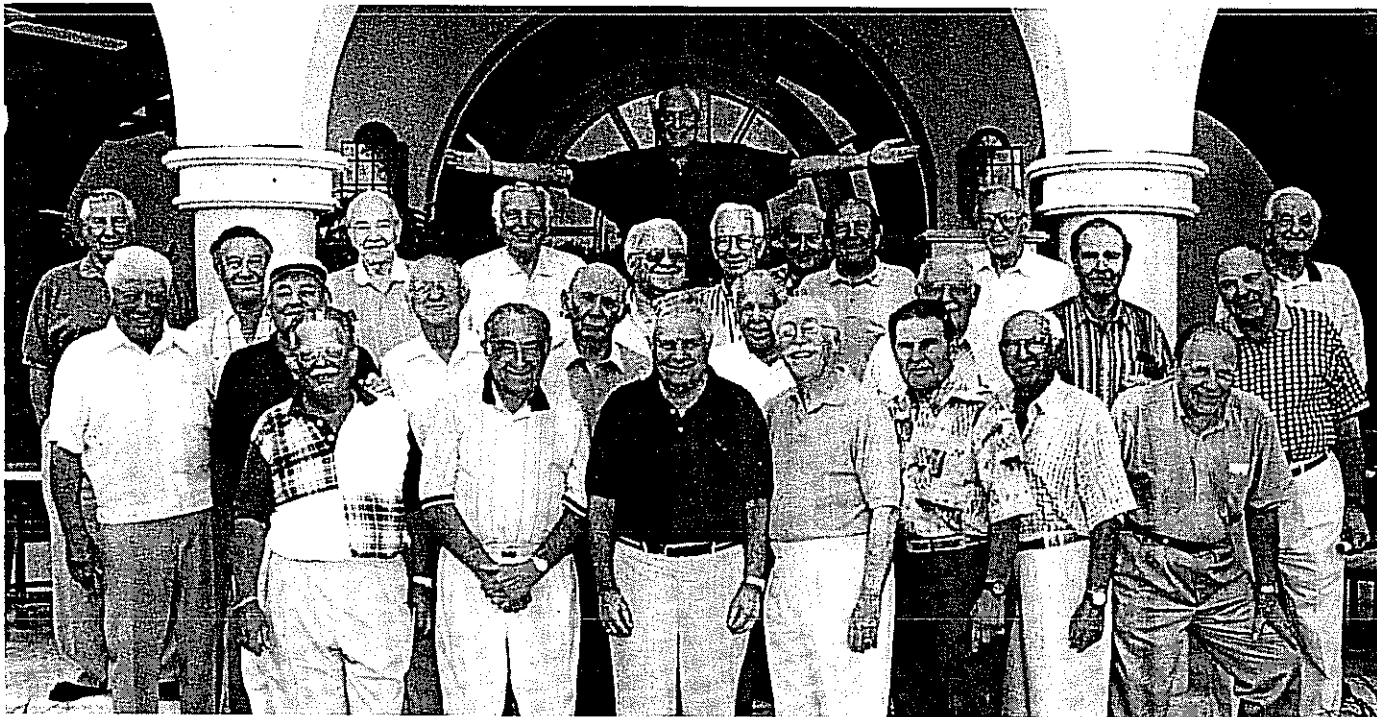
One of the most hard fought issues in contract law is whether to enforce a restrictive covenant against competition. On the one hand, it seems fair that a

principal should be able to include whatever provisions in the representation agreement, including restraints on competition, it can negotiate. If the principal cannot feel confident that the rep can protect confidential information or long-standing customer relationships, the principal may not hire the rep in the first place, or the principal may not give the rep the information and customer contracts the rep needs to exploit the territory effectively. No one forces a rep to consent to a restrictive covenant, and the rep may well receive a higher commission rate for agreeing to such a restriction. Meanwhile, by preventing the rep from competing, the principal may also be preventing another manufacturer from penetrating the territory. It need hardly be said that the economy works most efficiently and consumers' standards of living go up when many potential vendors battle fiercely for sales. Thus, the law has evolved a complex set of rules, which frequently call for hairline distinctions, to determine when a contractual restraint on competition should or should not be enforced.

A 1997 case from the United States District Court in Chicago — *Henri Studio, Inc. vs. Outdoor Marketing, Inc.* — illustrates how judges deal with these hairline distinctions. Henri, the principal, manufactured lawn and garden ornaments, which were sold through national department stores such as Wal-Mart and Home Depot. Outdoor Marketing represented Henri in the states of Texas and Oklahoma and at the Home Depot buying offices in Atlanta, Ga., and Tampa, Fla. The representation agreement provided that, for two years after its termination, Outdoor Marketing would not "directly or indirectly contact any then current

(continued on page 28)

Gerald M. Newman, partner in the Chicago law firm of Schoenberg, Fisher, Newman & Rosenberg, Ltd., serves as general counsel to ERA and is a regular contributor to The Representor. He participates in Expert Access, the program that offers telephone consultations to ERA members.



ERA Life Member Milt Dienes (Mid-Lantic) rounded up an electronics industry crowd of manufacturers, reps and distributors who are enjoying the good life in Florida. How many can you recognize? Milt writes that he has been very involved in photography. He has had numerous showings and has won many competitions. His photos have been nationally published. Earlier this year, he served as "designated" photographer at the Special Olympics at the Penn Relays.

LEGALLY SPEAKING

(continued from page 23)

customer of Henri Studio for the purpose of selling ... lawn statuary or other items similar to the Products."

On September 24, 1996, Henri notified Outdoor Marketing that the representation agreement was to be terminated on October 31, 1996. On November 1, 1996, Outdoor Marketing began to represent a competitor of Henri. Outdoor Marketing's first act thereafter was to solicit many of Henri's customers on behalf of its new principal. On December 13, 1996, Henri sued Outdoor Marketing for enforcement of the restrictive covenant. Henri then moved for a preliminary injunction to prevent Outdoor Marketing from contacting its customers.

In deciding the motion for a preliminary injunction, the court noted that a covenant of the sort between Henri and Outdoor Marketing would be enforceable only if Henri had a legitimate business interest to

protect. The court also noted that customer relationships were a protectable interest only if they were of a near-permanent nature or if the principal were trying to protect trade secrets. The question, therefore, was whether either of those situations applied to this case.

The court first found that Henri did not have a near-permanent relationship with its customers. Those customers would regularly attend trade shows where they would be solicited by Henri's competitors. Also, the customers usually purchased statuary ornaments from competitors. Even though some of those customer relationships had been developed after Henri's devotion of considerable time and expense, the highly competitive marketplace meant that Henri could not have a proprietary interest in its customers.

The court then found that Henri had not imparted any trade secrets to

Outdoor Marketing. The information that Outdoor Marketing had learned while serving as Henri's rep was, for the most part, sales information that was publicly available through such sources as telephone books and industry publications. Moreover, Henri had not attempted to safeguard the information by, for example, restricting its distribution or warning Outdoor Marketing that it should be treated as confidential.

Consequently, the court held that although Outdoor Marketing had violated the restrictive covenant, the covenant was not legally enforceable. Thus, the court denied Henri's motion for a preliminary injunction and Outdoor Marketing was free to represent its new principal without restriction. Each case involving a restrictive covenant of these types of cases stands on its own facts, and unfortunately, it is often difficult to predict the outcome in advance. ■