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Illinois Appellate Court Holds That Only Material Breaches Justify Nonperformance of Restrictive Covenants

Addressing an argument frequently encountered in restrictive covenant litigation, an Illinois Appellate Court recently reiterated that only a material breach of a contract containing a restrictive covenant will relieve the other party of its contractual obligation to abide by the restrictive covenant.

In the case *InsureOne Indep. Ins. Agency v. Hallberg*, the plaintiffs purchased assets of several insurance companies owned or controlled by James Hallberg, and subsequently hired Hallberg to become the company's new president. Hallberg's employment agreement – as well as the Asset Purchase Agreement (APA) that governed the original sale of assets – contained noncompetition and nonsolicitation clauses. The APA also contained details for computation and payment of the contingent purchase price, which was a portion of the overall purchase price based on renewal business from Hallberg's former entities.

Hallberg's tenure with InsureOne was short-lived, and soon after his departure, he established Hallberg Insurance Agency. Hallberg hired twenty-nine former InsureOne employees and directly competed with his former company. InsureOne subsequently filed suit alleging Hallberg breached his restrictive covenants. Hallberg claimed that InsureOne breached the APA by miscalculating the contingent purchase price and underpaying him. The trial court held that Hallberg breached his restrictive covenants and awarded InsureOne approximately $7.7 million in damages. Additionally, the court determined InsureOne had in fact underpaid the contingent purchase price by approximately $130,000 and awarded this amount to Hallberg.

On appeal, Hallberg argued that InsureOne was barred from recovery because it, too, breached the agreements by failing to pay the full amount of the contingent purchase price. However, the Appellate Court rejected the contention that InsureOne was required to demonstrate proof of such literal or strict performance. Instead, the court noted that "a party suing for breach of contract need only allege and prove that he has substantially complied with all the material terms of the agreement." Therefore, a "partial breach by one party" will not "justify the other party's subsequent failure to perform." Rather, "both parties may be guilty of breaches, each having a right to damages." Accordingly, the court held that only a "material breach of a contract provision will justify nonperformance by the other party."

The court subsequently determined that the underpayment of a mere $130,000 on a $16 million deal did not rise to the level required for a breach to be deemed material. According to the court, the test of whether a breach is "material" is whether it is so "substantial and fundamental as to defeat the objects of the parties in making the agreement, or whether the failure to perform renders performance of the rest of the contract different in substance from the original agreement." The court stated this was not the case, and highlighted Hallberg's unwillingness to rescind the deal as evidence that he could not have believed the entire deal had been compromised by InsureOne's breach.

This case illustrates that under basic contract law principles, a party wishing to enforce the terms of a noncompetition or nonsolicitation agreement does not have to prove literal or strict performance of every single term in the agreement. Unless an employer's breach is material in nature, an employee will remain legally bound to the terms of their employment agreement.

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