Legal Update Article

Illinois Bill to Further Limit Use of Restrictive Covenants With Employees Headed to Governor's Desk

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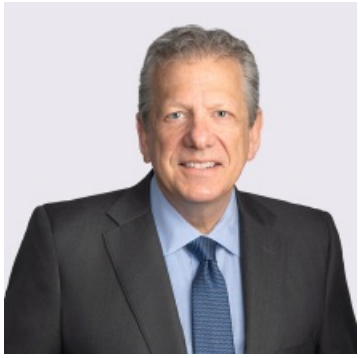
Meet the Authors



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COVID-19
Restrictive Covenants, Trade Secrets and Unfair Competition

The Illinois General Assembly passed a major bill on May 31, 2021, that further limits and clarifies the circumstances in which restrictive covenants can be enforced against Illinois employees. Governor J. B. Pritzker is expected to sign the bill into law.

A product of extensive negotiations between interest groups representing both employees and businesses, the new law imposes several unique regulations on agreements with covenants not to compete *and* covenants not to solicit.

The new law goes into effect January 1, 2022, and applies to agreements entered on or after that date.

Explicit Inclusion of Covenants Not to Solicit

Illinois initially regulated restrictive covenants with the Freedom to Work Act (2017), which outlawed "covenants not to compete" for "low-wage employees," defined as those making legal minimum wage or less than $13.00 per hour, whichever is greater. It was unclear whether the law's definition of "covenants not to compete" included covenants not to solicit customers or employees.

The new law will amend the Freedom to Work Act to clearly apply to both covenants not to compete *and* covenants not to solicit. This is a significant change, because other states that have recently regulated restrictive covenants generally have *not* expressly affected covenants not to solicit.

The new restrictions on covenants not to solicit would apply not only to provisions aimed at prohibiting solicitation of customers and vendors, but also the solicitation of employees. The law excludes certain types of agreements from the definition of a "covenant not to compete," including confidentiality provisions, invention assignment agreements, and covenants entered in the context of the sale of a business, among others.

Expanding Compensation Threshold for Restrictive Covenants

The new law will substantially expand the compensation threshold for enforceable restrictive covenants.

Under the new law, covenants not to compete will be invalid and unenforceable for employees with "actual or expected" earnings of less than $75,000 per year (inclusive of salary, bonuses, commissions, or any other form of taxable compensation). This threshold will increase on the following schedule:

- $80,000 on January 1, 2027
- $85,000 on January 1, 2032

- $90,000 on January 1, 2037

Perhaps in recognition that covenants not to solicit are generally less burdensome on employees than covenants not to compete, the monetary threshold for these provisions is lower. Covenants not to solicit will be invalid and unenforceable for employees earning less than $45,000 per year (inclusive of salary, bonuses, commissions, or any other form of taxable compensation). These figures will increase as follows:

- $47,000 on January 1, 2027
- $50,000 on January 1, 2032
- $52,000 on January 1, 2037

Codifying *Fifield* Requiring Two Years of Employment for Adequate Consideration

Since 2013, Illinois employers have operated under the rule established by the Illinois Appellate Court for the First District, First Division, in *Eric Fifield and Enterprise Financial Group, Inc. v. Premier Dealer Services, Inc.*, 373 Ill. Dec. 379, 993 N.E. 2d 938 (Ill. App. Ct. 2013), requiring employers to provide employees with "at least two years or more of continued employment" as consideration for signing a restrictive covenant, if at-will employment itself (as opposed to some other benefit) is the consideration for the agreement. The *Fifield* decision is not without controversy: some courts have declined to apply the two-year *Fifield* rule.

The new law will end the controversy by codifying the *Fifield* two-year rule. If the employer does not provide "professional or financial benefits adequate by themselves" (*i.e.,* some non-illusory benefit other than at-will employment), then "adequate consideration" is defined as "at least two years" of employment after signing the agreement.

Illinois employers should take note of this requirement before they entrust new employees with confidential information, trade secrets, or customer relationships.

Carving Out Certain Employees Impacted by COVID-19 or Similar Circumstances

In addition to codifying some well-established common law principles, the new law will address a novel concern. It will void covenants not to compete and covenants not to solicit for employees furloughed or terminated due to business circumstances or governmental orders related to COVID-19 or under similar circumstances. However, if the employee is bound to a covenant not to compete (but not a covenant not to solicit), the employer can enforce the covenant by paying the employee's base salary from the date of termination through the period of enforcement, minus compensation earned through subsequent employment during the enforcement period. There does not appear to be an option to enforce a covenant not to solicit against employees furloughed or terminated under these circumstances.

Judges have considered the impact of the COVID-19 pandemic in weighing the equities of injunctive relief in restrictive covenant cases. The new law will remove uncertainty regarding enforcement for employees who fit within the carve-out.

Other Key Enforcement Provisions

The new law contains provisions that are important for employers who intend to use and

enforce restrictive covenants to protect their legitimate business interests. These include:

- Requiring employers to advise employees in writing to seek attorney consultation and provide at least 14 calendar days to review a restrictive covenant prior to signing.
- Allowing prevailing employees to recover costs and reasonable attorneys' fees in civil actions filed by employers to enforce restrictive covenants.
- Prohibiting covenants not to compete (but not covenants not to solicit) for individuals covered by a collective bargaining agreement under the Illinois Public Labor Relations Act or the Illinois Educational Labor Relations Act or individuals employed in construction. However, construction employees who primarily perform management, engineering or architectural, design, or sales functions for the employer or are a shareholder, partner, or owner in any capacity of the employer may be covered by a covenant not to compete or a covenant not to solicit.
- Granting the Illinois attorney general the right to initiate investigations and initiate or intervene in any civil action to compel compliance whenever the attorney general has reasonable cause to believe that any employer has engaged in a pattern and practice prohibited by the new law. The attorney general will have subpoena power to investigate potential violations and may request a court to impose civil penalties not to exceed $5,000 for each violation or $10,000 for each repeat violation within a five-year period. Each person who is subject to an agreement in violation of the new law will constitute a separate and distinct violation.
- Codifying the "blue pencil" doctrine, which allows a court to reform a restrictive covenant in its discretion. The statutory factors for consideration would be the fairness of the restraints as originally written, whether the original agreement reflects a good-faith effort to protect a legitimate business interest, the extent of the reformation, and whether the parties included a clause authorizing modification in the agreement.

Given the statutory "blue pencil" factor, employers should consider including a provision in their restrictive covenants that confirm the parties authorize judicial reformation. The law still gives judges latitude in deciding against rewriting contracts that overreach.

Next Steps for Illinois Employers

Illinois employers should re-evaluate their needs and consider revising agreements to fit within the new legal requirements. Additionally, employers should continue to assess how they can further protect their legitimate business interests in other ways, such as strengthening internal safeguards for sensitive information, preparing a departing employee drill, and reviewing the incoming employee due diligence process.

The effective date of this new law is set for January 1, 2022. Two of its sections (limiting the use of non-compete clauses to employees earning at least $75,000 and non-solicit clauses to employees earning at least $45,000) are applicable only to contracts entered into after January 1, 2022. However, their existence raises questions as to the likelihood of contract enforcement with employees earning less than the threshold amounts prior to 2022.

We will continue to analyze these issues and explore their practical impact for employers.