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CLIENT ALERT

Illinois Passes Landmark Restrictive Covenant Legislation

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On August 13, 2021, a significant amendment to the Freedom to Work Act became law in Illinois. The new legislation will provide Illinois employees greater protections in the areas of employee non-competition and non-solicitation agreements entered into beginning in 2022.

Highlights of the law include: (i) $75,000 minimum annual compensation for employees subject to non-competes ($45,000 for non-solicits); (ii) codification of the two-year minimum employment rule where at-will employment is the only consideration supporting the covenant; (iii) a 14-day period for employees to review non-competes and/or non-solicits before signing; and (iv) mandatory attorney's fees for prevailing employees in enforcement actions brought by employers.

While some provisions of the new legislation will provide employers greater certainty as to the standards that courts will apply in analyzing restrictive covenants, other key provisions will require judicial interpretation likely to take years to solidify. In other words, it could be some time before employers can take comfort that their Illinois non-competition and non-solicitation agreements governed by the new legislation will be enforceable.

To put themselves in the best possible position to have restrictive covenants that are enforceable under the new legislation, employers should take steps well before the legislation's January 1, 2022 effective date, to ensure that the restrictive covenants entered into after that date comply with the law's procedural and substantive requirements.

WHAT TYPES OF AGREEMENTS ARE COVERED?

The new legislation applies to "covenants not to compete" and "covenants not to solicit."

Covenants not to compete are defined in the Act as agreements entered into between an employer and employee that restrict the employee from performing:

i. any work for another employer for a specified period of time;

ii. any work in a specified geographical area; or

iii. work for another employer that is similar to such employee's work for the employer included as a party to the agreement.

Significantly, the definition also includes agreements that impose adverse financial consequences on post-employment competition (*e.g.*, forfeiture-for-competition agreements), placing such agreements on equal footing with prohibitory non-competes in terms of judicial scrutiny applicable to them.

Covenants not to solicit are defined as agreements between an employer and an employee that restrict the employee from:

i. soliciting for employment the employer's employees; or

ii. soliciting, for the purpose of selling products or services of any kind to, or from interfering with the employer's relationships with, the employer's clients, prospective clients, vendors, prospective vendors, suppliers, prospective suppliers, or other business relationships.

WHAT TYPES OF AGREEMENTS ARE EXCLUDED?

In addition to any agreement entered into before January 1, 2022, the new legislation explicitly excludes from its coverage (i) confidentiality agreements/covenants, (ii) invention assignment agreements, (iii) agreements/covenants entered into by a person purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest (*e.g.*, "sale of business" non-competes), (iv) agreements not to reapply for employment after termination, and (v) garden leave clauses/agreements, *i.e.*, provisions requiring a paid period of notice before the employment relationship terminates.

The exclusion of sale-of-business restrictive covenants is potentially significant, but the extent of its significance must await judicial interpretation. For example, was the exclusion a signal by the Illinois legislature that such covenants should be afforded less judicial scrutiny than ordinary restrictive covenants? If so, how much less? Further, the definition of such covenants will likely become the subject of extensive litigation. For example, does the granting of a *de minimis* equity interest in connection with entering a restrictive covenant take the covenant outside the Act's scope?

WHAT IS REQUIRED FOR AN ENFORCEABLE NON-COMPETE OR NON-SOLICIT?

The Act provides that non-competition and non-solicitation agreements are illegal and void unless *all* of the following are true:

1. **The employee receives adequate consideration.** This is an area that will continue to confound Illinois employers. On the one hand, the Act embraces the bright-line two-year rule derived from the Illinois Appellate Court's 2013 decision in *Fifield v. Premier Dealer Services, Inc.*, which held that where a covenant is supported only by at-will employment, such employment must last at least two years in order for there to be adequate consideration. There had been inconsistent application of this rule (particularly as between the Illinois state versus federal courts), and the Act's codification of this rule provides certainty. On the other hand, for those employers seeking the assurance of adequate consideration at the outset of employment, uncertainty continues to reign. If the two-year threshold is not satisfied, non-competition and non-solicitation agreements must be supported by additional "professional or financial benefits." What professional or financial benefits are sufficient to support a covenant is left unanswered by the Act, leaving that question to the courts to decide.
2. **The covenant is ancillary to a valid employment relationship**.
3. **The covenant is no greater than is required for the protection of a legitimate business interest of the employer**. Here, the Act borrows from existing Illinois case law (most notably, the Illinois Supreme Court's 2011 decision in *Reliable Fire Equipment Co. v. Arredondo*) by codifying the principles that the existence of a legitimate

business interest is determined based on "the totality of the facts and circumstances of the individual case," and that reasonableness of a covenant "is gauged not just by some, but by all of the circumstances." The legislation further cribs from *Reliable Fire* by codifying that "[t]he same identical contract and restraint may be reasonable and valid under one set of circumstances and unreasonable and invalid under another set of circumstances."

4. **The covenant does not impose an undue hardship on the employee**. The Act does not expound on the meaning of undue hardship, leaving the principle to continue to be enunciated by the courts. In general, in looking at undue hardship, courts look at the extent to which enforcement of the covenant would deprive the employee of the ability to earn a living in his/her chosen field.
5. **The covenant is not injurious to the public.**

In addition, the Act establishes minimum compensation thresholds ($75,000 in annualized compensation for non-competes, increasing by $5,000 every five years so that by 2037 the minimum will be $90,000; $45,000 for non-solicits, increasing $2,500 every five years so that by 2037 the minimum will be $52,500).

WHAT OTHER KEY PROVISIONS ARE FOUND IN THE ACT?

Prevailing Employee Attorney's Fees. The Act provides that employees who prevail in an action by their employer to enforce a non-compete or non-solicit "shall" be entitled to their costs and reasonable attorney's fees. This provision is designed to provide a powerful deterrent to employers seeking to enforce overbroad covenants or covenants in situations where enforcement is not warranted.

Employees Must Be Advised to Consult an Attorney and Provide a 14-day Consideration Period. Employees must be advised—in writing—to consult an attorney before signing the agreement. Further, employers must either provide the employee with a copy of the non-competition or non-solicitation agreement at least 14 days before the beginning of employment or give the employee at least 14 days to consider the agreement. The period is waivable at the option of the employee, meaning that he or she can choose to sign the contract earlier.

Extensive Judicial Reformation of Overbroad Covenants Is Discouraged. By explicitly discouraging (although not prohibiting) extensive judicial modification of overbroad covenants, the Act incentivizes employers to engage in careful drafting of covenants, knowing they cannot rely on a court to reform a covenant it finds too broad.

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Key Takeaways for Illinois Employers

- The new legislation does not apply to covenants entered into before January 1, 2022, and the law does not, in and of itself, provide any reason to enter into new covenants with existing employees who already have valid covenants in place.
- Employers concerned with the law's requirements can consider whether it is feasible to select another state's laws to govern their agreements. Employers should proceed with caution, however, as courts may not accept such provisions, depending on the circumstances of the employment relationship.
- By January 1, 2022, employers using restrictive covenants in Illinois should ensure those agreements conform to the new legislation, including by having a process in place to ensure that employees are given the required 14-day review period and notified in writing to consult an attorney regarding the agreement.
- Employers should consider whether Garden Leave agreements would work as an effective substitute for non-compete agreements, at least for certain portions of their workforces. One shortcoming of Garden Leave agreements is that they generally are ineffective as a basis to obtain an injunction against a departing employee who chooses to violate the notice requirement.
- The new legislation could have a dramatic effect on employers that rely on forfeiture-for-competition covenants in equity agreements. Even if another state's law purportedly applies to such arrangements (*g*., New York or

Delaware), employees may try to argue that Illinois public policy mandates application of Illinois law to such agreements as applied to Illinois workers. Carefully crafting restrictive covenants in award agreements to survive and/or to avoid application of the new legislation will be of paramount importance.

- Employers should carefully consider what additional professional or financial benefits they can provide in exchange for non-compete and non-solicit agreements. Such benefits likely will differ depending on the employer and the employee's role but should be substantial enough that the employer can credibly take the position the benefits are "adequate" consideration for the covenant.

On the whole, the Act appears designed to compel employers to think critically and to exercise care in determining which employees will be subject to restrictive covenants and how broadly those covenants should be drafted. While this more individualized approach may require additional work on the front-end, it is necessitated by the new legislation and should ensure a greater likelihood of successful enforcement later.

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