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EMPLOYMENT LITIGATION AND COUNSELING ADVISORY

Illinois Enacts Restrictions on the Use of Non-Compete Agreements: What Employers Need to Know

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KEY POINTS

- Effective January 1, 2022, employers will need to comply with significant new amendments to the Illinois Freedom to Work Act (the Act), a previously narrow statute restricting the use of non-competes with low wage workers.

- In its new expanded version, signed into law by Governor Pritzker on August 13, the Act extends the prohibition on non-competes to higher wage earners, limits the use of non-solicit restrictions, codifies the requirements for enforceable restrictive covenants, adds a disclosure requirement and consideration period for employees, and allows Illinois Attorney General enforcement and civil penalties.

- Companies using restrictive covenants should act now to familiarize themselves with these changes and revise their template agreements to conform with the new requirements highlighted in the following Katten advisory.

Compensation Threshold for Non-Competes: No Longer Just Low-Wage Workers

The Act, originally passed in 2017, outlawed non-compete agreements for low-wage workers, defined as employees earning less than $13/hour or minimum wage. The amendment deletes mention of "low-wage" and creates a higher compensation threshold for the imposition of non-compete restrictions. Now, employers are prohibited from entering into non-compete agreements with employees who earn less than $75,000 annually. The law defines "earnings" to include salary, bonuses, commissions, "or any other form of taxable compensation." The threshold increases to $80,000 on January 1, 2027, and by $5,000 every five years thereafter through 2037.

Adequate Consideration: the "Two-Year Rule" or "Professional or Financial Benefits"

The Act now purports to define "adequate consideration" for non-compete obligations, although the statutory definition provides little practical guidance.

In a 2013 decision, an Illinois appellate court held that employment at-will alone was insufficient consideration for a post-employment non-compete. Since then, Illinois state courts have generally required at least two years of tenure or some form of financial consideration to support a non-compete. The federal courts have been more flexible, but employers have not had clear guardrails on the consideration issue.

The Act now states that "adequate consideration" means at least two years of continued employment after the agreement is signed *or* another form of consideration sufficient to support a non-compete. The amendment does not spell the "other" option out with precision, but it does suggest that "merely professional or financial benefits" may be "adequate by themselves." We will need to await judicial interpretation to see how closely courts evaluate consideration, and what they consider to be "adequate."

Non-Solicitation Provisions: Also Subject to Restrictions

The amended Act goes farther than its predecessor by regulating non-solicitation provisions as well. A "covenant not to solicit" may restrict a former employee from pursuing the employer's other employees or from going after clients, vendors, suppliers and other business relationships, or both. Previously, non-solicitation provisions, unlike their non-competition counterparts, were not subject to a compensation threshold. Now they are.

The compensation threshold for a non-solicit is lower than that for a non-compete. The new law prohibits non-solicitation restrictions for employees who earn less than $45,000 per year. Like the non-compete thresholds, the non-compete threshold scales up, to $47,500 in January 2027, and by $2,500 every five years thereafter through 2037.

Disclosure Requirements: Counsel and Consideration Periods

For non-competes and non-solicits to be enforceable, employers must now advise employees in writing to consult with counsel before signing the agreement. Additionally, employers must give employees at least 14 calendar days to review a copy of the agreement before they acquiesce to its terms. As long as the employer provides the requisite advice on counsel and gives the employee two weeks to review and sign, employers will be in compliance even if the employee waives these rights.

Reformation of Overly Broad Restrictions: Within Court Discretion

The Act expressly vests courts with the discretion to reform or sever overreaching provisions of a non-compete or non-solicit rather than strike them down as unenforceable, while noting that extensive judicial reformation may be against Illinois public policy. When considering whether or not to exercise such discretion, the judge may take into account the fairness of the restraints as originally written, whether the employer engaged in a good-faith effort to protect a legitimate business interest, the extent of reformation needed and whether the parties authorized modification in their agreement. Employers should *always* include a provision authorizing judicial reformation.

Attorneys' Fees: Prevailing Employees Entitled to Recover

The amendments up the ante for employers who initiate a civil action or arbitration to enforce a non-compete or a non-solicit. In the revised Act, prevailing employees "shall recover from the employer all costs and reasonable attorneys' fees." Additionally, the court or arbitrator may award other "appropriate relief."

State Enforcement: Attorney General Empowered to Investigate, Initiate Action

The Illinois Attorney General can investigate (with subpoena power) any employer it believes "is engaged in a pattern or practice prohibited" by the Act, and initiate a civil action if appropriate. Additionally, the Attorney General can request a court to impose a civil penalty up to $5,000 for each violation or $10,000 for each repeat violation within a five-year period.

Checklist for Employers

- Going forward, do not implement non-competition and non-solicitation agreements for employees earning less than $75,000 or $45,000, respectively, as such agreements will no longer be enforceable under Illinois law. Consider using confidentiality or trade secret agreement instead and/or strengthening internal safeguards;

- Provide upfront and explicitly reference an additional professional or financial benefit that will qualify as adequate consideration for a non-compete or non-solicit obligation;
- Review non-compete and non-solicit agreements and ensure they include the following provisions:
  - a statement advising the employee to consult with a counsel before signing;
  - a consideration period of at least 14 calendar days to review the covenant before signing; and
  - an express authorization for judicial reformation;
- Review agreements to ensure they make a good-faith effort to be appropriately and narrowly tailored to meet a legitimate business interest; and
- Consider if your company has a reasonable nexus to another state that is more conducive to the enforcement of non-compete and non-solicit provisions. If so, confer with counsel about the advisability of utilizing a "choice of law" provision to designate that state as the governing law.

Takeaway

In Illinois, restrictive covenants have long been subject to close judicial scrutiny due to their impact on the free market economy. With amendment of the Illinois Freedom to Work Act, the stakes are even higher for employers. Companies should take stock of the new requirements, and continue to ensure their restrictive covenant agreements are appropriately tailored to protect their legitimate business interests without imposing an undue hardship on employees. Our team at Katten can help you analyze these issues and make appropriate adjustments.

CONTACTS

For more information, contact your Katten attorney or either of the following Employment Litigation and Counseling attorneys.

Julie L. Gottshall
+1.312.902.5645
julie.gottshall@katten.com

Janet R. Widmaier
+1.312.902.5546
janet.widmaier@katten.com