NEW RESTRICTIVE COVENANT LAW HOLDS TRAPS FOR UNWARY EMPLOYERS

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Important amendments to the Illinois Freedom to Work Act (the "Act") became effective January 1, 2022. The Act pertains to both "covenants not to compete" and "covenants not to solicit" entered into with employees after that effective date. The Act formerly applied only to "low-wage workers" earning less than $13.00 per hour. However, the compensation-based provisions of the Act now have substantially higher minimums, and most of the Act now applies to virtually all employees, regardless of compensation level. Of even greater concern for employers are the Act's new attorneys' fees and civil penalty provisions.

Agreements Addressed

The definition of "covenant not to compete" under the Act is broad and includes agreements restricting an employee from working for a period of time, in a particular geographic location, or for a competitive business enterprise. It does not, however, include confidentiality agreements or restrictions on use or disclosure of an employer's trade secrets. Further, the Act's restrictions are limited to employment relationships and do not apply to restrictive covenants entered in connection with the purchase of a business.

The definition of "covenant not to solicit" is likewise broad and includes agreements restricting an employee from soliciting an employer's other employees, or from soliciting or interfering with an employer's clients, vendors, suppliers, prospective clients, vendors, or other business relationships.

Compensation-Based Provisions

Under the amended Act, an employer is prohibited from entering a covenant not to compete with an employee earning less than $75,000 per year. This amount has statutory escalations beginning in 2027 and increases to $90,000 by 2037. Likewise, covenant not to solicit agreements are prohibited for employees earning less than $45,000 per year. This minimum is subject to similar escalations beginning in 2027 and increases to $52,500 by 2037.

Provisions Not Limited by Compensation

Importantly, the Act now implements several objective and subjective limitations on employee covenant not to compete and covenant not to solicit agreements (collectively "Restrictive Covenants") without regard to the level of earnings. Virtually all employers now need to assure that their Restrictive Covenants comply with these provisions.

First, the Act requires an employer to notify the employee in writing of the employee's right to consult an attorney before signing a Restrictive Covenant and provide the employee 14 days to review the Restrictive Covenant agreement before signing it. The employee can elect not to consult with counsel and to voluntarily waive this 14-day period but must be given those rights in writing by the employer. The Act provides that a Restrictive Covenant that fails to meet these requirements is "illegal and void."

Next, the Act codifies in certain aspects of Illinois case law with respect to what constitutes "adequate consideration" for an employee to enter a Restrictive Covenant. The Act provides that for there to be adequate consideration, the employee must: (a) continue to work for the employer for two years after signing the Restrictive Covenant agreement; or (b) receive other consideration adequate to support a Restrictive Covenant, which consideration may consist of "a period of employment plus additional professional or financial benefits, or merely professional or financial benefits adequate by themselves." Unfortunately, there is no statutory clarity on what might be considered adequate "professional or financial benefits." Inclusion of the word "adequate" within the Act likely means a merely nominal benefit or bonus may well be insufficient. It's probable that these definitions are destined to be clarified only through future case law.

Finally, in determining enforceability, the Act requires a subjective legal review of whether a Restrictive Covenant imposes undue hardship on an employee, is not injurious to the public, and serves a "legitimate business interest of an employer." This review is required to be based on the "totality of the facts and circumstances of the individual case" applying factors derived from Illinois case law. These factors include: (i) the employee's exposure to the employer's business relationships or employees; (ii) the near-permeance of the employer's relationship with customers; (iii) the length, scope, and geographical limitations of the restriction; and (iv) the employee's acquisition and use of confidential information during employment.

Judicial Reformation

The Act specifically permits a court, in its discretion, to revise what it considers to be an overly broad Restrictive Covenant, a practice commonly known as blue-penciling. In deciding whether to reform an agreement, the court is advised to consider factors such as the fairness of the restrictions as originally drafted, how much change is needed to make them reasonable, and whether they reflected a good faith effort to protect the legitimate business interest of the employer. The court may also consider whether the parties included a clause permitting the court to modify their agreement. However, the Act makes clear that extensive judicial reformation may be against public policy and a court may refrain from wholly rewriting contracts.

Miscellaneous Prohibitions

The Act provides that Restrictive Covenants may not be enforced against: (a) an employee terminated due to COVID-19 (unless they receive full salary during such restriction period); (b) employees covered under collective bargaining agreements under the Illinois Public Labor Relations Act or the Illinois Educational Labor Relations Act; or (c) individuals employed in construction, excluding employees who primarily perform management, engineering or architectural, design, or sales functions for the employer or who are partners or owners.

Fees and Civil Penalties

It is critical to note that the Act now provides that if an employee prevails in a Restrictive Covenant enforcement case, the employee is entitled to attorneys' fees and costs. The Act provides that the employee "shall" receive such attorneys' fees and costs, not "may." An employer needs to be very confident in its ability to prevail before seeking judicial enforcement of a Restricted Covenant.

Further, the Illinois Attorney General's office is charged with overseeing statutory compliance with the Act and is authorized to obtain compensatory and equitable remedies against employers, including injunctions and restraining orders. The Attorney General may also seek civil penalties against employers of $5,000 for the first violation and $10,000 for each additional violation to be deposited into an Illinois State fund.

Conclusion and Action Items

It is imperative for employers to assure that they do not attempt to obtain employee covenant not to compete or covenant not to solicit agreements that are prohibited by the Act. Failure to monitor such compliance with the Act could result in legal remedies and monetary penalties. In addition, employers should confirm that permitted Restrictive Covenants contain the required statutory notices and ideally provide consent for a court to modify the restrictions if it deems it necessary for enforcement. Finally, employers must review their Restrictive Covenants to consider whether they provide adequate consideration to the employee and protect only the employer's legitimate business interest considering the totality of the facts and circumstances. ◆

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