Changes Coming to Illinois Restrictive Covenant Law

Written by Sarah R. Marmor

In late May 2021, the Illinois legislature passed a new bill that, if signed into law as expected, will have some significant impacts on Illinois restrictive covenant agreements. (A link to the bill is here, https://www.ilga.gov/legislation/102/SB/PDF/10200SB0672ham001.pdf) The new law is expected to become effective on January 1, 2022, but will not be retroactive. Employers should examine their restrictive covenant agreements and policies this year to ensure they comply with the terms of the new law for any employees who are hired or asked to sign these agreements (in return, for example, for bonuses or stock grants) in 2022 and going forward.

In many respects, the statute simply codifies existing Illinois common law regarding restrictive covenants. What is really new are salary thresholds defining who can and cannot be subject to these sorts of agreements, a special rule for pandemic (and like) terminations and furloughs, and "due process" rights to ensure employees are told to get, and have time to obtain, legal advice before signing a restrictive covenant agreement.

While those "due process" rules may require more up-front work by employers, as well as revisions to their agreements, in the long run this should help employers who want to enforce their agreements later, as many employees seem not to pay sufficient attention to these agreements and sign them at the beginning of their employment and then forget about them. However, the statute also permits a prevailing employee to get attorney's fees – a major shift in the law that levels the playing field in an area where many restrictive covenant agreements have a one-way fee provision that only permits the employer to get prevailing party fees. The upside for some employers, however, is that this new rule may make a former employer less likely to sue over a departing employee – a boon to the company the employee wants to join.

Finally, the statute also provides parameters under which a court may "blue pencil" a restrictive covenant agreement – i.e. rewrite an otherwise unenforceable provision or enforce part of an agreement even if other parts are invalid.

Here are the major provisions of interest in the statute:

First, the law codifies the factors Illinois courts already consider in determining whether a covenant not to compete or a covenant not to solicit is enforceable:

Enforceability of a covenant not to compete or a covenant not to solicit. A covenant not to compete or a covenant not to solicit is illegal and void unless (1) employee receives **adequate consideration**, (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**, (4) the covenant **does not impose undue hardship on the employee**, and (5) the covenant is not injurious to the public.

Second the law codifies the "two-year" rule for **"adequate consideration"** articulated in Fifield v. Premier Dealer Services, Inc. 2013 Ill. App. (1st) 120327 under which a restrictive covenant agreement (non-compete and non-solicit obligations) will only be deemed enforceable either if the employee has worked for the employer for at least two years after signing the agreement or the employer otherwise provided consideration for the agreement. Courts and commentators have been uncertain what constitutes adequate consideration for restrictive covenant agreements – whether a cash payment or training or something else – and the new law at least attempts to define this aspect of "adequate consideration" as:

the employer otherwise provided consideration adequate to support an agreement to not compete or to not solicit, which consideration can consist of a period of employment **plus additional professional or financial benefits or merely professional or financial benefits adequate by themselves**.

While this definition is not particularly prescriptive, the provision as a whole resolves a long-standing split between federal and state courts in Illinois. Many federal courts had refused to follow the 2-year bright line rule set out by Fifield, while state courts did. This split provided an incentive, depending on which side one was on, to forum shop in Illinois – which now should be unnecessary as federal courts can be expected to follow the terms of the statute.

Third, Section 7 of the statute codifies how courts will determine **"legitimate business interests of the employer."** In Illinois, for a restrictive covenant agreement to be enforceable, the employer must show that the restrictions serve a legitimate business interest. In Reliable Fire Equipment Co. v. Arredondo, 2011 IL 111871 the Illinois Supreme Court adopted a "totality of the circumstances" approach to making a "legitimate business interest" determination, and the new statute adopts the same approach:

In determining the legitimate business interest of the employer, **the totality of the facts and circumstances of the individual case shall be considered**. Factors that may be considered in this analysis include, but are not limited to, the employee's exposure to the employer's customer relationships or other employees, the near-permanence of customer relationships, the employee's acquisition, use, or knowledge of confidential information through the employee's employment, the time restrictions, the place restrictions, and the scope of the activity restrictions. No factor carries any more weight than any other, but rather its importance will depend on the specific facts and circumstances of the individual case. Such factors are only non-conclusive aids in determining the employer's legitimate business interest, which in turn is but one component in the 3-prong rule of reason, grounded in the totality of the circumstances. **Each situation must be determined on its own particular facts. Reasonableness is gauged not just by some, but by all of the circumstances. The same identical contract and restraint may be reasonable and valid under one set of circumstances and unreasonable and invalid under another set of circumstances.**

While the "2-year or other consideration" rule gives litigants a fairly bright line test for enforceability, the "legitimate business interest" rule as articulated by the legislature is a reminder that litigation in this area

is fact-intensive. Employers seeking to enforce their agreements will need to come to court prepared to tell a compelling story about why an employee's violation of an agreement requires redress. Even if on its face an agreement is enforceable, the nature of the specific employee's job, what information the employee possesses, and the damage the employee has done or could do if working for a competitor or soliciting clients or employees all will determine if an employer really has the ability to enforce the terms of the agreement.

Fourth, the law bars covenants not to compete for any employee making less than **$75,000 per year**. This threshold will rise by $5,000 increments every five years after 2022, through January 1, 2037.

Fifth, there also is a threshold for covenants not to solicit employees or clients. These can only apply to employees making more than **$45,000 a year** ("annualized rate of earnings"). That threshold will rise by $2,500 every five years after 2022, through January 1, 2037.

Sixth, employers may not enter into either non-competes or non-solicits with an employee who was laid off or furloughed as a result of business circumstances related to the Covid-19 **pandemic or similar circumstances** – unless enforcement includes payment of base salary for the duration of the restricted period, minus pay the employee is able to earn during the enforcement period.

Seventh, the statute requires employers to (1) **advise the employee in writing** to **consult with an attorney** before signing an agreement and (2) provide the employee **14 calendar days** to consider the agreement.

Finally, while the statute makes clear that Illinois disfavors complete reformation of restrictive covenant agreements, it does permit courts in their discretion in some circumstances:

choose to reform or sever provisions of a covenant not to compete or a covenant not to solicit rather than hold such covenant unenforceable. Factors which may be considered when deciding whether such reformation is appropriate include the fairness of the restraints as originally written, whether the original restriction reflects a good-faith effort to protect a legitimate business interest of the employer, the extent of such reformation, and whether the parties included a clause authorizing such modifications in their agreement.

This "blue pencil" provision also codifies what courts in Illinois already do, so is not likely to signal a major shift in how courts address restrictive covenant agreements.

The bottom line for employers is that the new law will require a revision of agreements and policies with respect to restrictive covenant agreements with Illinois employees. The revisions should not be too onerous. The policies – including the types of consideration to offer for these agreements, changes to what lower paid employees may be exposed to in client and other relationships, and determination of what a company's legitimate business interests are at the outset of these agreements and if litigation looms – may present more challenges to employers under the new law.

For more information please contact Sarah R. Marmor at smarmor@scharfbanks.com

Sarah R. Marmor

Sarah R. Marmor concentrates her practice on employment law, complex business litigation, and life sciences/product liability. Sarah has tried complex cases throughout the United States, in state courts in Illinois, Colorado, Oklahoma, Louisiana and Texas and in federal courts in Illinois, Michigan, California and New York.