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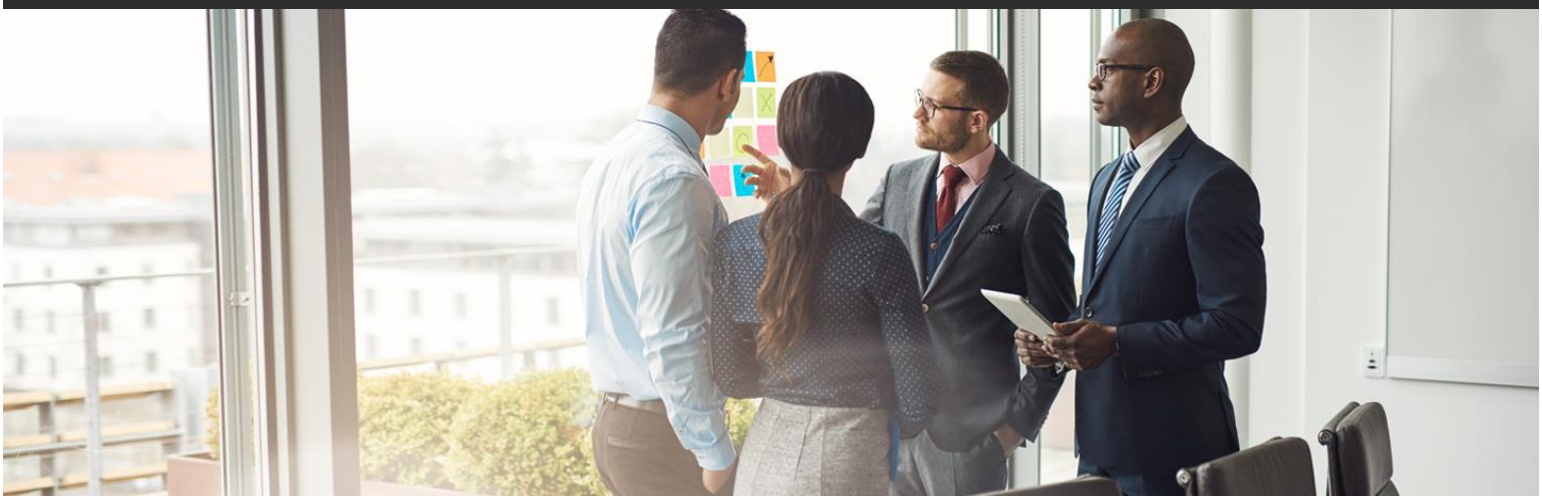

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Illinois Legislature Passes Sweeping Non-Compete and Non-Solicitation Bill

The Illinois General Assembly has unanimously passed a bill that will significantly affect the legality of post-employment non-competition and non-solicitation agreements between employers and their Illinois employees entered into after Jan. 1, 2022. Illinois Gov. J.B. Pritzker is expected to sign the bill into law. The bill, Amendment 1 to SB 672, amends the Illinois Freedom to Work Act in several respects. The amendment:

- Codifies the definitions of "covenant not to compete" and "covenant not to solicit" and carves out certain exceptions, as summarized later in this GT Alert;
- Requires that a covenant not to compete or covenant not to solicit be supported by "adequate consideration" to the employee, ancillary to a valid employment relationship, contain restrictions no greater than the protection of the employer's legitimate business interest, not impose undue hardship on the employee, and not be injurious to the public;
- Defines "adequate consideration" as either: (i) two years of continuous employment with the employer after the employee signs a non-competition or non-solicitation agreement, or (ii) employment of the individual by the employer for "a period of employment" plus additional professional or financial benefits or merely professional or financial benefits that are "adequate by themselves." These requirements essentially codify the criteria for adequate consideration established by the Illinois Appellate Court for the First District (Cook County) in *Fifield v. Premier Dealer Services*, 993 N.E.2d

938 (2013), which have not been unanimously adopted by Illinois state and federal courts. However, the bill does not define "a period of employment" or "adequate by themselves," leaving those judgments up to further interpretation;

- Codifies the "totality of circumstances" test for determining the employer's "legitimate business interest" as established by the Illinois Supreme Court in *Reliable Fire Equipment Co. v. Arredondo*, 965 N.E.2d 393 (2011). In that case, the court applied a three-prong test of reasonableness to restrictive covenants that are ancillary to an employment relationship. In order to meet that test, the covenant: (i) must be no greater than is required for the protection of a legitimate business interest of the employer; (ii) must not impose undue hardship on the employee; and (iii) must not be injurious to the public. The court explained: "Whether a legitimate business interest exists is based on the totality of the facts and circumstances of the individual case. Factors to be considered in this analysis include, but are not limited to, the near-permanence of customer relationships, the employee's acquisition of confidential information through his employment, and time and place 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." 965 NE2d at 403;
- Requires the employer to (i) advise the employee in writing to consult with an attorney before entering into a non-competition or non-solicitation covenant, and (ii) provide the employee with a copy of such covenant(s) at least 14 calendar days before the employee begins employment or provide the employee at least 14 calendar days to review the covenant(s). An employee may voluntarily sign the covenant agreement before the 14-day period expires;
- Prohibits non-competition covenants with employees who have actual or expected "earnings" of $75,000 per year or less (to increase by $5,000 every five calendar years beginning Jan. 1 of each such year until the threshold of $90,000 is reached)."Earnings" include all forms of earned compensation reported on the employee's IRS W-2 form such as salary, bonuses and commissions, plus elective deferrals that are not reflected on the employee's W-2, such as employee contributions to a 401(k) or 403(b) plan, a flexible spending account, or a health savings account, or commuter benefit-related deductions;
- Prohibits non-solicitation covenants with employees who have actual or expected "earnings," as defined above, of $45,000 per year or less (to increase by $5,000 every five calendar years beginning Jan. 1 of each such year until the threshold of $52,500 is reached);
- Prohibits non-competition covenants with employees covered by collective bargaining agreements under the Illinois Public Labor Relations Act or the Illinois Educational Labor Relations Act, and any employees employed in construction, except such employees who primarily perform management, engineering or architectural, design or sales functions, or who are shareholders, partners or owners in the employer; and
- Prohibits non-competition covenants and non-solicitation covenants with any employee who an employer terminates, furloughs or lays off as a result of business circumstances or governmental orders related to the COVID-19 pandemic or under circumstances similar to the pandemic. An exception to this prohibition exists if the covenant includes compensation to the employee equivalent to the employee's base salary at the time of such a separation through the restricted period, less compensation earned by the employee through subsequent employment during the enforcement period.

Covenants Not to Compete and Not to Solicit

The bill defines "covenant not to compete" as an agreement between an employer an employee entered into after Jan. 1, 2022, that restricts 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 the employee's work for the employer that is a party to the covenant. This definition further includes an agreement between an employer and employee that by its terms imposes adverse financial consequences on an employee if the employee engages in competitive activities with the employer after the employee's separation of employment with the employer. Excluded from the definition of "covenant not to compete" are: covenants not to solicit; confidentiality agreements and agreements prohibiting the use or disclosure of trade secrets or inventions; invention assignment agreements; agreements by a person purchasing or selling the goodwill of a business or acquiring or disposing of an ownership interest in a business; agreements that require advance notice of termination of employment during which the employee receives compensation and remains an employee of the employer; and agreements by which an employee agrees not to reapply for employment with the same employer after the employee's termination of employment with the employer. The bill defines "covenant not to solicit" as an agreement between an employer and employee that: (i) restricts the employee from soliciting the employer's employees for employment, or (ii) restricts the employee from 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.

Illinois courts have historically upheld covenants not to compete and not to solicit that are broader in scope than those contained in employments agreements where the agreements are ancillary to sale and purchase of a business, even in situations where an owner of the selling entity becomes an employee of the purchaser. The bill, as written, excludes covenants or agreements by a person purchasing or selling the goodwill of a business or acquiring or disposing of an ownership interest in a business from the definition of "covenant not to compete." However, that provision contains no similar reference to the exclusion from the sale of ownership of business agreements from the definition of "covenant not to solicit." It is not clear whether that omission was intentional or was an oversight by the legislature. Until this issue is clarified, employers who purchase businesses should proceed with caution in drafting covenants not to solicit in purchase agreements in situations where they agree to hire the previous owner or seller.

Reformation of Overly Broad Covenants

The bill also provides guidance on when courts may modify overly broad covenants rather than holding them unenforceable. Courts continue to enjoy broad discretion to modify or sever an otherwise unenforceable restriction. Therefore, it is not clear whether these provisions of the bill will have any effect on the historic reluctance of Illinois state judges to reform otherwise unenforceable post-employment restrictions. In order for a court to exercise this discretion, the agreement between the employer and employee should specifically authorize the court (or an arbitrator) to do so.

Remedies for Violations

Employees who prevail in actions or arbitrations by employers to enforce covenants not to compete or not to solicit are entitled to recover their costs and reasonable attorney's fees and such other relief that the court or arbitrator determines appropriate, as well as any relief authorized under the agreement between the parties or under any other applicable statute. A fee-shifting provision in favor of a prevailing employer is not prohibited in the bill.

Attorney General Enforcement

The Illinois attorney general, on behalf of the People of Illinois, may intervene in any civil action or initiate a civil action if the attorney general has reasonable cause to believe that there is a pattern or practice of conduct prohibited by the bill. In addition to other legal and equitable relief, the attorney general may seek a civil penalty of up to $5,000 for each violation or up to $10,000 for each repeat violation within a five-year period. A violation is considered separate for each employee who was subject to an invalid agreement under the bill. The attorney general may also conduct an investigation prior to initiating such an action and require compliance with the investigation.

Key Takeaways for Employers

Although the bill will apply only to covenants not to compete and not to solicit entered into after Jan. 1, 2022, employers may wish to take the opportunity before that date to have legal counsel review their existing non-competition and non-solicitation agreements with Illinois employees, including fee-shifting provisions. Employers may consider entering into new or updated agreements before that date or modifying existing agreements to better conform to the bill's requirements, since courts may look to those requirements in construing pre-bill covenants. Once the bill is effective, employers will need to work with legal counsel to comply with the new law for new and modified covenant agreements for Illinois employees. Choice of law and forum provisions will also need to be carefully considered. In general, this bill is not favorable to employers, and if enacted into law, it raises significant concerns about predictability of contract enforcement and government intrusion into employment agreement terms that are important to many companies.

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