Illinois Restrictive Covenants Face A Sea Change If Bill Passes

By **Christopher Hennessy and Jeremy Glenn**

Christopher Hennessy

Jeremy Glenn

Illinois courts, and to perhaps a lesser extent, the Illinois Legislature,[1] have long struggled with restrictive covenants in the employment context.

On the one hand, Illinois courts have sustained such covenants when reasonable to protect the interests of the business[2] and even stepped in to reform them when some of the restrictions are reasonable yet others found not to be.[3]

On the other hand, although Illinois courts have historically been willing to modify or reform agreements to be reasonable where they otherwise were not, courts of late have expressed some reluctance to salvage an agreement on behalf of an employer, thus voiding the agreements altogether.[4]

In addition, the unique facts of each case have often resulted in unique rulings, making predictions over the enforceability of a restrictive covenant feel like a moving target for Illinois employers.

Events in Springfield this year may well bring some clarity for both employers and employees.

On Jan. 8, a bill was introduced in the Illinois Legislature that, if made into law, would rewrite significant aspects of the law of restrictive covenants entered into after the effective date of its adoption into law, including barring some altogether.

Among other things, H.B. 789[5] eliminates restrictive covenants for all employees earning below threshold salaries, makes the agreement illegal and void unless the employer advises the employee in writing to see a lawyer, and entitles the employee to attorney fees if the employee prevails in litigation regarding the agreement.

H.B. 789 also sets out criteria for a court to use when evaluating reformation of a restrictive covenant. If passed in its current form, H.B. 789 would represent a sea change in Illinois on the law of restrictive covenants.

This potential action by the Illinois Legislature might seem unusual but for the fact that other states have already passed similar laws. In the last few years, several legislatures have stepped into the restrictive covenant arena that is more often the purview of courts.

For example, as of Jan. 1, 2020, noncompetition agreements in Washington are void and unenforceable for employees earning less than $100,000 a year[6] and are presumed to be unenforceable when the duration is more than 18 months (though that presumption is rebuttable).[7]

Effective Jan. 15, 2020, Rhode Island barred enforcement of noncompetition agreements for, among others, workers who are nonexempt from overtime under the Fair Labor Standards Act, employees 18 or younger, and low-wage employees.[8]

Effective Jan. 1, 2020, Oregon bars enforcement of noncompetition agreements unless a

number of factors are met, including that the employee's annual gross salary and commission "exceeds the median family income for a four-person family, as determined by the United States Census Bureau."[9]

On Jan. 11, 2021, the mayor of the District of Columbia signed the Ban on Noncompete Agreements Amendment Act of 2020 that forbids noncompete agreements for most employees, and subjects an employer who violates the act to penalties.[10]

Illinois House Bill 789 has several notable threshold provisions regarding the validity of restrictive covenants:

- Covenants not to compete[11] are not valid for employees unless their "actual or expected" annualized rate of earnings exceeds $75,000 per year, indexed to increase over time;

- Covenants not to solicit[12] are not valid for employees unless their "actual or expected" annualized rate of earnings exceeds $45,000 per year, indexed to increase over time;

- Covenants not to compete are "void and illegal" for any employee terminated as a result of the COVID-19 pandemic "or under circumstances that are similar to the COVID-19 pandemic" unless the employer pays the employee's base salary for the period of enforcement, minus any compensation the employee earns during the enforcement period, and

- Both covenants not to compete and not to solicit are "illegal and void" unless (1) the employee receives "adequate consideration,"[13] (2) the agreement is ancillary to a valid employment relationship, (3) the covenant is "no greater than is required for the protection of the legitimate business interests of the employer,"[14] (4) the covenant "does not impose undue hardship" on the employee, and (5) the covenant is not "injurious to the public."

In addition to these specific provisions regarding when enforcements are simply not valid or the requirements necessary to support them, H.B. 789 imposes additional restrictions on an employer.

Even if all the above criteria are met, a covenant not to compete or a covenant not to solicit would be "void and illegal" if the employer fails to advise the employee in writing to consult with an attorney prior to signing the covenant and fails to provide the employee with at least 14 calendar days to review the covenant.

By comparison, the Oregon statute contains an "at least two weeks" provision[15] but does not require notice in writing advising the employee to have the agreement reviewed by an attorney.

Also marking a significant departure from the current state of the law, H.B. 789 provides that if an employee prevails in a civil action filed by an employer — "including, but not limited to a complaint or counterclaim" — the employee shall recover "all costs and all reasonable attorney's fees regarding such claim."

Again, by comparison, the Washington statute provides for the recovery of attorney fees if a court finds that the agreement violates the statute, as well as a statutory penalty of $5,000.[16] Where a court reforms or modifies an agreement, the party seeking enforcement must likewise pay attorney fees and either actual damages or a statutory penalty.[17]

Finally, H.B. 789 includes a provision on reformation, as discussed above, the tool used by Illinois courts when evaluating a restrictive covenant that has a mix of reasonable and unreasonable terms, noting that "extensive judicial reformation of a [restrictive] covenant … may be against the public policy" of Illinois and therefore "a court may refrain from wholly rewriting contracts."

Apart from the public policy discussion, the "wholly rewriting contracts" language certainly echoes comments in some recent court decisions.[18]

Should a court, in its discretion, elect to reform a covenant, the bill outlines "factors which may be considered" including the fairness of the restraints as originally written[19], whether those restrictions reflect a good faith effort to protect a legitimate business interest of the employer,[20] the extent that the covenant would be reformed, and whether the agreement included a clause authorizing modification.[21]

Employer Takeaways

Ultimately the question is where this leaves Illinois employers should some version of H.B. 789 turn into law. The Illinois Freedom to Work Act already provides protections for the low-wage employee.

This new bill amends and expands those protections to a much larger portion of the workforce. Should a version of H.B. 789 pass, employers will have to carefully consider restrictive covenants such that they are narrowly tailored depending on the specific employee.

For employees below the two thresholds $75,000 for noncompetes, and $45,000 for nonsolicits, restrictions would no longer be an option.

Another factor to consider is that by its terms, the covenants covered by H.B. 789 are limited to those "entered into after the effective date" of the act.

This is in contrast to Washington's statute that bars all causes of action regarding a noncompetition covenant signed before the effective date "if the noncompetition covenant is not being enforced."

In other words, even if a restrictive covenant was signed by an employee before Jan. 1, 2020, those restrictions are no longer enforceable by the employer.[22] There is no similar retroactive language in H.B. 789, so in its current form, covenants entered before the effective date should be outside its reach.

The attorney review and attorney fee provisions in H.B. 789 are also a significant shift in the

enforcement of otherwise valid agreements. In the end, Illinois may well be moving into a new, far more restrictive landscape on restrictive covenants.

This is assuredly legislation that employers and employees alike will want to monitor.

Christopher Hennessy and Jeremy Glenn are members at Cozen O'Connor.

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[1] The Illinois legislature, for its part, passed the Illinois Freedom to Work Act in 2017, which states that employers are prohibited from entering into non-compete agreements with Illinois employees who earn $13 an hour or less.820 ILCS 90/1 (2000).

[2] See, e.g., Cockerill v. Wilson, 281N.E.2d648 (Ill. 1972); Canfield v. Spear, 254N.E.2d433 (Ill. 1969). When assessing the enforceability of covenants not to compete, Illinois courts have focused on numerous factors, including whether the employer has a protectable business interest, whether the durational and geographic scopes are reasonable, and whether enforcement would be injurious to the public. See, e.g., Retina Services, Ltd. v. Garoon, 538 N.E.2d 651 (Ill. App. Ct. 1989); Akhter v. Shah, 456N.E.2d232 (Ill. App. Ct. 1983).

[3] See, e.g., Gillespie v. Carbondale, 622 N.E.2d 1267 (Ill. App. Ct. 1993) (affirming judicial modification of geographic limitation); Weitekamp v. Lane, 620 N.E.2d 454, 461 (Ill. App. Ct. 1993) ("A court may modify the restraints in a covenant not to compete."); Arpac Corp. v. Murray, 589 N.E.2d 640, 652 (Ill. App. Ct. 1992) (affirming trial court's "reasonable" and "slight" modifications, and noting that the agreement in question contained a modification clause).

[4] See, e.g., Cambridge Engineering, Inc. v. Mercury Partners 90 BI, Inc., 879 N.E.2d 512 (Ill. App. Ct. 2007) (acknowledging that employees "unschooled in the law" would not be expected to know the reasonable from the unreasonable, the court went on to comment that judicial reformation "should be looked upon with suspicion"); Deere Employees Credit Union v. Smith, 2016 IL App (3d) 150516-U (finding that judicial reformation to be "not favored," as it would provide employers with the incentive to overreach with respect to the restrictive covenant with the comfort in knowing that the court will save them from their over-drafting); AssuredPartners, Inc. v. Schmidt, 2015 IL App (1st) 141863 (declining to reform an employment agreement, noting that in light of what it found to be significant deficiencies, modifying the agreement's terms "would be tantamount to fashioning a new agreement.")

[5] https://ilga.gov/legislation/101/HB/PDF/10100HB0789ham001.pdf.

[6] Wash. Rev. Code Ann. §49.62.020(1)(b).

[7] Wash. Rev. Code Ann. §49.62.020(2).

[8] R.I. Gen. Laws §28-59-3 (2000). The statutes defines "low wage employees" as those who earn not more than 250% of the federal poverty level for individuals. R.I. Gen. Laws

§28-59-2(7).

[9] Or. Rev. Stat. § 653.295(1)(d).

[10] D.C. Act 23-563.

[11] A covenant not to compete is defined as "an agreement … that by its terms imposes adverse financial consequences on a former employee if the employee engages in competitive activities" after the termination of their employment.

[12] A covenant not to solicit is defined to include both the solicitation of the employer's employees and the employer's "clients, prospective clients, vendors, prospective vendors, suppliers, prospective suppliers, or other business relationships."

[13] Adequate consideration includes employment for at least two years after signing the agreement or where the employer provided "consideration adequate to support an agreement … which could consist of the period of employment plus additional consideration or merely other consideration adequate by itself."

[14] As to the "legitimate business interests of the employer," H.B.789 codifies the factors discussed by the Illinois Supreme Court in Reliable Fire Equipment Company v. Arredondo , 2011 IL 1111871.

[15] Or. Rev. Stat. § 653.295(1)(a)(A).

[16] Wash. Rev. Code Ann. §49.62.080(2).

[17] Wash. Rev. Code Ann. §49.62.080(3).

[18] See, e.g., AssuredPartners, Inc., 2015 IL App (1st) 141863 (noting that modifying the agreement's terms "would be tantamount to fashioning a new agreement.")

[19] This language appears in a number of cases. See, e.g., Cambridge Engineering, 879 N.E.2d at 529 ("… the fairness of the restraints contained in the contract is a key consideration.")

[20] The "business interests" language also appears in the case law. See, e.g., AssuredPartners, Inc., 2015 IL App (1st) 141863, at ¶¶51-52.

[21] Although an unpublished Rule 23 Order and therefore not of precedential value, the court in Deere Employees Credit Union v. Smith, commented on the import of such a provision. Deere Employees Credit Union v. Smith, 2016 IL App (3d) 150516-U, ¶36 ("Significantly, [the employer] did not include the severability language necessary to salvage this Contract in the event that the trial court found select provisions of the Contract were overly broad and unenforceable as written.")

[22] United Energy Workers Healthcare Corp. v. Atlantic Home Health Care, LLC, No. 4:19-CV-5283-RMP, at 12-13 (E.D. Wash., Oct. 8, 2020).