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New Restrictions on Non-Competes and Non-Solicits: What Employers Should Know

Employers should review their form agreements and practices to determine what modifications may be required to comply with new restrictions in Illinois, Oregon, Nevada, and Washington, D.C.

Key Points:

- Effective January 1, 2022, the Illinois Freedom to Work Act (IFWA) will be amended to prohibit employers from entering into non-competes and non-solicits with employees who earn $75,000 or less and $45,000 or less, respectively.[1] The amended IFWA will also (i) require employers to counsel employees to consult with an attorney before entering into a non-compete or non-solicit, (ii) require employers to give employees at least 14 days to consider signing a non-compete or non-solicit, and (iii) permit the Illinois Attorney General to pursue action and impose monetary penalties against employers whose practices violate the IFWA.

- Effective January 1, 2022, the Oregon non-compete law will be amended to require employers to limit the temporal restrictions in non-competes to 12-months post-termination. The law will also prohibit employers from enforcing non-competes against employees who are classified as non-exempt and/or earn $100,533 or less per year, unless the employer has agreed in writing to pay the employee during the post-termination restricted period in accordance with the law.

- Effective October 1, 2021, the Nevada non-compete law was amended to make non-competes with hourly employees unenforceable.

- The D.C. Ban on Non-Compete Agreements Amendment Act, discussed here, was expected to apply in October 2021, but now will apply on April 1, 2022.

While most non-compete covenants are governed by state common law, in the past several years state legislatures have passed laws that generally restrict the use of non-compete covenants. Latham & Watkins discussed this trend generally here, with updates on the Massachusetts non-compete law effective in 2018 discussed here and the Washington State and other state non-compete laws effective in 2019 and 2020 discussed here. In 2021, the trend continued, with non-compete-related changes in Illinois, Oregon, Nevada, and Washington, D.C., and potential federal development on the horizon.

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Illinois

Currently, the IFWA prohibits employers from entering into non-compete covenants with employees who do not earn more than applicable minimum wage or $13 per hour (whichever is greater). Effective January 1, 2022, an amendment to the IFWA will further limit an employer's use of non-compete and non-solicit covenants. The amendments to the IFWA cover the following topics and may require prompt changes to non-compete and non-solicit practices and forms in Illinois:

Minimum Salary Requirements

Under the IFWA amendment, employers are prohibited from entering into covenants not to compete with employees whose actual or expected annualized earnings are $75,000 or less per year (with the salary threshold increasing by $5,000 every five years until that threshold reaches $90,000 in 2037).

The amendment also prohibits employers from entering into covenants not to solicit with employees whose actual or expected annualized earnings are less than $45,000 per year (with the salary threshold increasing by $2,500 every five years until that threshold reaches $52,500 in 2037).

The IFWA amendment defines a covenant not to compete as an agreement entered into between an employer and an employee after January 1, 2022, that:

- Restricts an 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 included as a party to the agreement; or
- By its terms imposes adverse financial consequences on a former employee if the employee engages in competitive activities after the termination of the employee's employment.

The IFWA amendment defines a covenant not to solicit as an agreement entered into between an employer and an employee on or after January 1, 2022, that restricts an employee from:

- Soliciting the employer's employees for employment; or
- 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, vendors, or suppliers, prospective clients, vendors, or suppliers, or other business relationships.

The IFWA amendment applies to "employees" and does not expressly address independent contractors. However, the amendment broadly defines an "employee" as "any individual permitted to work by an employer in an occupation," which could be interpreted to include any individual who is engaged on an independent contractor basis.

Other Limitations on Covenants Not to Compete and Covenants Not to Solicit

Under the amendment to the IFWA, an employer may not enter into a covenant not to compete or a covenant not to solicit with an employee who is terminated, furloughed, or laid off as a result of business circumstances or governmental orders related to the COVID-19 pandemic or under circumstances similar to the COVID-19 pandemic, unless during the enforcement period the employer provides the employee with compensation equal to the employee's base salary at the time of termination, minus compensation earned through subsequent employment during the enforcement period.

Additionally, the IFWA as amended states that a covenant not to compete entered into with individuals covered by a collective bargaining agreement under the Illinois Public Labor Relations Act or the Illinois

Educational Labor Relations Act or with certain individuals in a broadly defined "construction" industry are illegal and void.

Adequate Consideration

Under the IFWA amendment, covenants not to compete and covenants not to solicit are illegal and void, unless (i) the employee receives adequate consideration, and (ii) the covenant is ancillary to a valid employment relationship, is not greater than is required for the protection of a legitimate business interest of the employer, does not impose undue hardship on the employee, and is not injurious to the public.

Under existing Illinois law, neither new nor continued at-will employment alone is adequate consideration when entering into a covenant not to compete, unless employment actually continues for at least two years (according to an Illinois appellate case law) or for a substantial period of time if less than two years (according to Illinois federal case law).

The IFWA amendment codifies Illinois appellate case law and defines "adequate consideration" for both covenants not to compete and covenants not to solicit as:

- At least two years of work with the employer after signing a covenant not to compete or a covenant not to solicit; or
- Other consideration adequate to support an agreement not to compete or not to solicit, which could consist of a period of employment plus additional professional or financial benefits, or merely professional or financial benefits adequate by themselves.

While the IFWA amendment provides some much-needed clarification as to what length of at-will employment constitutes adequate consideration, it raises the questions of what "additional professional or financial benefits" and what "professional or financial benefits" will be deemed by courts to be sufficient consideration.

Advice and 14-Days' Notice to Employees

The IFWA as amended requires employers desiring to enter into a covenants not to compete and/or covenants not to solicit (i) to advise the employee, in writing, to consult with an attorney before entering into the covenant, and (ii) to provide the employee with a copy of the covenant at least 14 calendar days before the employee starts employment or provide the employee with at least 14 calendar days to review the covenant prior to requiring it to be signed. Employees may waive the remainder of the 14-days' notice period by voluntarily signing the covenant before the expiration of the 14-day period.

An employer's failure to meet either requirement renders the covenant illegal and void.

Judicial Modification

The amendment to the IFWA states that courts may, in their discretion, reform or sever provisions of a covenant not to compete and covenant not to solicit rather than refuse to enforce the entire covenant. The amendment also provides that, in deciding whether to reform or sever covenants not to compete and covenants not to solicit, some factors a court may consider 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.

Notably, the IFWA as amended states that extensive judicial reformation may be against public policy and that courts may refrain from wholly rewriting contracts.

Attorneys' Fees and Illinois Attorney General Action

Under the IFWA as amended, an employee who prevails on a claim or counterclaim brought by an employer to enforce a covenant not to compete or a covenant not to solicit can recover all costs and reasonable attorneys' fees incurred regarding the claim or counterclaim, in addition to any remedies available under any agreements between the parties or another statute, and any other relief awarded by the court or arbitrator. The amendment does not address attorneys' fees recoverable by the employer.

The amended IFWA also authorizes the Illinois Attorney General to sue any "person or entity" that it believes is engaged in a pattern and practice prohibited by the IFWA. As drafted, it is not clear if "person" could include officers, supervisors, or other individuals acting on behalf of the employer.

The Illinois Attorney General may impose a civil penalty not to exceed $5,000 for each violation or $10,000 for each repeat violation within a five-year period.

Exclusions From the IFWA

The IFWA amendment does not apply to covenants entered into on or prior to January 1, 2022, and the definition of covenant not to compete excludes certain agreements and covenants, such as confidentiality covenants restricting the use or disclosure of confidential information, invention assignment provisions, and non-compete covenants entered into by a person purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest.

Oregon

Amendments to Oregon's non-compete statute take effect on January 1, 2022. These amendments further restrict the use of non-compete covenants in Oregon in the following key ways:

12-Month Limit

Existing Oregon law prohibits non-compete covenants that exceed 18 months post-termination. Under the law as amended, non-compete covenants entered into on or after January 1, 2022, must not have a temporal restriction that exceeds 12 months post-termination.

Minimum Salary Requirements or Agreement to Pay

Under the Oregon amendment, a non-compete covenant entered into on or after January 1, 2022, is void if the employee (i) is not an administrative, executive or professional exempt employee under Oregon wage and hour laws and/or (ii) is not paid a gross salary, together with any commissions, exceeding $100,533 per year (to be adjusted annually for inflation) at the time of the employee's termination. For non-compete covenants entered into prior to January 1, 2022, an employee's annual gross salary and commissions at the time of termination have to exceed the median family income for a four-person family, as determined by the US Census Bureau. The minimum pay requirement does not apply to certain on-air talent.

If an employee is non-exempt or does not meet the minimum pay requirements, a non-compete covenant entered into after January 1, 2022, may still be enforceable against the employee if the employer agrees in writing to provide the employee with pay during the post-termination restricted period equal to the greater of (i) 50% of the employee's annual gross base salary and commissions at the time of termination, or (ii) 50% of $100,533, adjusted annually for inflation. For agreements entered into prior to

January 1, 2022, it is sufficient for an employer to provide such pay regardless of whether the employer has agreed to do so in writing; for agreements entered into on or after January 1, 2022, the employer's written agreement to provide such pay is also required.

Non-Compliant Non-Competes Are Void

Non-compete covenants entered into on or after January 1, 2022, that do not comply with the Oregon non-compete law are void, and not merely voidable as the law previously provided.

Existing Rules and Exclusions

The Oregon amendment does not modify, and employers should be mindful of, other existing Oregon non-compete rules and exclusions that continue to apply, including:

- If a non-compete covenant is required upon hire, the employer must inform the employee of this requirement in a written employment offer letter received by the employee at least two weeks before the first day of work, or the non-compete covenant must be entered into upon a subsequent bona fide advancement of the employee.
- In order to enforce a non-compete agreement, the employer must provide the employee with a signed written copy of the non-compete covenant within 30 days after the employee's termination.
- Oregon's non-compete law does not apply to non-competes entered into with properly classified independent contractors, unless the individual is a musician or supporting technical person.
- Oregon's non-compete law does not apply to bonus restriction agreements (i.e., reasonable non-compete agreements that upon breach result in a forfeiture of profit sharing or other bonus compensation that has not yet been paid to the employee) and agreements to not solicit employees or to not solicit or transact business with the employer's customers.

Nevada

Effective October 1, 2021, the Nevada statute regarding non-compete covenants was modified in the following key ways:

- Non-compete covenants do not apply to employees in Nevada who are paid solely on an hourly wage, exclusive of any tips or gratuities. The law also instructs courts to award reasonable attorneys' fees to such employees in any action to enforce or challenge a non-compete.
- The law clarifies that courts are required to revise covenants that are supported by valuable consideration to the extent necessary and to enforce them as revised, both when an employer brings an action to enforce a non-compete and when an employee brings an action to challenge a non-compete.
- An employer cannot bring an action to restrict a former employee from providing services to a former customer or client of the employer if the former employee did not solicit the former customer or client and the former customer or client voluntarily chose to leave and seek services from the former employee. Non-competes restricting such services were prohibited by the law prior to the amendment, but the law now also instructs courts to award reasonable attorneys' fees to such former employees in any action in which an employer has so restricted or attempted to restrict the former employee.

Washington, D.C.

The D.C. Ban on Non-Compete Agreements Amendment Act of 2020 (Ban) took effect on March 16, 2021, but the date on which the Ban would begin to apply was uncertain due to the need for the Ban first to be approved in a budget. It was anticipated that the Ban would be applicable starting in October 2021.

Since then, the D.C. Committee on Labor and Workforce Development (Committee) recommended a delay in the applicability date, and the D.C. Mayor signed the Fiscal Year 2022 Budget Support Act of 2021, setting April 1, 2022, as the official applicability date for the Ban. The Committee also stated that it was considering changes to the Ban to respond to community concerns raised after the passage of the Ban, and at least one bill has been introduced to amend and clarify the Ban. Although employers should continue to prepare themselves for the Ban, it is possible that the Ban may be amended prior to its applicability date.

Potential Federal Rule

On July 9, 2021, President Biden issued an Executive Order that, among other things, encouraged the Federal Trade Commission (FTC) to exercise its statutory rulemaking authority to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility. While the FTC has not yet issued any rule regarding non-competes, in 2022 the FTC could move to restrict non-compete covenants nationwide.

If you have questions about this *Client Alert* or need help modifying your non-compete or non-solicit agreement forms based on the state law changes noted in this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

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Endnotes

[1] All values are in US$.