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LEGISLATING LOW-WAGE NON-COMPETES: RECONCILING POLICY INTERESTS WITH COMMON LAW

❖ NOTE ❖

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TABLE OF CONTENTS

I. INTRODUCTION.....	24
II. BACKGROUND.....	26
III. ANALYSIS.....	30
IV. RECOMMENDATION	33
V. CONCLUSION	36

I. INTRODUCTION

On October 25, 2017, the Illinois Attorney General’s Office filed a lawsuit in state court against Checks into Cash LLC., a subsidiary of a national payday loan retailer.¹ In the lawsuit, the Attorney General alleged that the company required employees to enter into non-compete agreements that are now impermissible under Illinois state law.² While ruling on the enforceability of non-compete agreements is nothing new for Illinois state courts, this case would now require the court to apply a completely new standard of rules.³ Illinois courts,

¹ Cara Salvatore, *Ill. AG Sues Payday Lender Over Noncompetes*, LAW360 (Oct. 25, 2017, 9:03 p.m.), <https://www.law360.com/articles/978509/ill-ag-sues-payday-lender-over-employee-noncompetes>.

² *Id.*

³ Illinois Freedom to Work Act, 820 ILL. COMP. STAT. 90/1 (2017).

employers, and employees relied on common law rules to determine the enforceability of non-compete agreements.⁴ That changed in part at the start of 2017 when the Illinois General Assembly enacted the Illinois Freedom to Work Act [“Work Act”], which prohibits companies from entering into non-compete agreements with low-wage workers.⁵ Thus, where a court previously would be able to use discretion in deciding whether the Check into Cash’s non-competes with its low-wage employees ought to be enforceable, a court would now have to automatically nullify the ones that involved low-wage employees. This change illustrates the potential for a gap in certain instances between the common law approach to the enforceability of some non-compete agreements, and the approach under the Work Act. As a recommended means of resolving this potential discrepancy, the state legislature should amend the Work Act to allow for specific exceptions when non-compete agreements with low-wage workers could be enforceable if upheld by a state court, thus preventing the statute from being overly broad without sapping its ability to accomplish important policy objectives.

The purpose of this Note is to explore a possible means of improving the Work Act by incorporating a small amount of narrowly-defined exceptions when non-compete agreement ought to be enforceable. Part II of this Note will give a brief background about the history of the legal enforceability of non-compete agreements in under Illinois state law. Part III will analyze the policy motivations driving the state’s ban on non-competes with low-wage employees, and how the passing of the Act could create a gap in some instances between the statutory and common law approach to whether a particular non-compete agreement should be enforceable. Lastly, Part IV will discuss a potential solution for reconciling these two conflicting ideologies so that the state can protect its citizens from unfair binding agreements without casting an overly broad restrictive net.

⁴ Matthew E Misichko, *Non-Compete Agreements in Illinois: Enhanced Inapplicability and Continuing Uncertainty*, CBA REC., July/Aug. 2017, at 34.

⁵ Illinois Freedom to Work Act, 820 ILL. COMP. STAT. 90/1 (2017).

II. BACKGROUND

Non-compete agreements are contracts between employers and employees where the employee generally promises “not to engage in or in any way be connected with a competing organization or product or service within a specified geographic area, and for a specific period of time.”⁶ In exchange for the employee’s promise not to compete, the employer often promises to continue to employ the employee for a reasonable period of time.⁷ These types of agreements are important to companies because businesses often use them to protect trade secrets, reducing employee turnover, and protecting investments in employee training.⁸

Up until the beginning of 2017, common law governed the enforceability of all non-compete agreements between employer and employees in Illinois.⁹ For a non-compete agreement to be enforceable under Illinois common law, the restraint on the employee must be reasonable, and the agreement must be supported by consideration.¹⁰ To constitute a “reasonable” restraint, Illinois state courts require that it is “(1) reasonably necessary to protect the legitimate business interest of the employer, (2) ancillary to a relationship or valid contract, and (3) reasonably supported to supported by adequate consideration.”¹¹

For a restrictive covenant to satisfy the requirement of protecting a “legitimate business interest,” employers must prove that the interest is reasonable based on total circumstances of the situation, which likely will depend on factors such as whether the employer’s customer relationship is nearly permanent, whether the employee acquired confidential information during the employment, as well as the relevance of the restriction’s form, duration, geographic scope, and

⁶ LAW J. PRESS, EMPLOYMENT LITIGATION § 3.05 (2018).

⁷ Tracy Staidl, *The Enforceability of Noncompetition Agreements When Employment is At-Will: Reformulating the Analysis*, 2 EMPL. RTS. & EMPLOY. POL’Y J. 95 (1998).

⁸ *Non-Compete Contracts: Economic Effects and Policy Implications*, Office of Econ. Policy, U.S. DEP’T. OF TREASURY (2016), <https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf>.

⁹ Misichko, *supra* note 4, at 35.

¹⁰ *Reliable Fire Equip. Co. v. Arredondo*, 965 N.E.2d 393, 396 (Ill. 2011).

¹¹ Misichko, *supra* note 4, at 35.

type of activity being restrained, toward the goal of appropriately protecting the employer's interest.¹² Additionally, in considering whether a restraint is "reasonably necessary," Illinois common law stipulates that courts should consider factors such as the hardship to the employee, the length of time for the employer obtain new customers or clients, and the non-compete agreement's effect on the public.¹³ For example, when an insurance company contracted with an at-will employee not to interfere with the company's clients for two years after leaving said employment, an Illinois appellate court held that the restraint was reasonably necessary to protect the employer's "legitimate business interest," since the employee had a "near-permanent relationship" with the employee's clients.¹⁴ Illinois courts have frequently come down on the other side of the "reasonableness" spectrum, however. In 2013 for example, an Illinois appellate court struck down an agreement between Pepsi and three low-level employees that required the employees not to compete or provide confidential information to competitors for two years, reasoning that the restraint was unreasonable since there was no evidence that the employees obtained any confidential information as a result of their employment.¹⁵

In addition to the restraint in a non-compete agreement needing to be reasonable and ancillary to the original employment agreement, Illinois common law also requires non-compete agreements to be supported by adequate consideration, meaning that the employee must receive something of value in return for promising not to compete. When it comes to agreements with at-will employees, whom the employer is free to dismiss at any time, Illinois courts have consistently held that continued employment for a "substantial period" following the signing of the agreement can serve as adequate consideration for the employee's promise not to compete.¹⁶ The most prominent Illinois appellate decision regarding what constitutes a "substantial period" took place in *Fifield v.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Lyle R. Jager Agency v. Steward*, 625 N.E.2d 397, 403 (Ill. App. 3d 1993).

¹⁵ *Pepsi MidAmerica, Inc. v. Mullinax*, 2013 IL App (5th) 120396-U, at *25.

¹⁶ LITTLER MENDELSON, LITTLER ON ILLINOIS EMPLOYMENT LAW, § 2.3 (2017).

Premier Dealer Servs., where the court held that two years of continued employment following the signing of a non-compete is sufficient to constitute adequate consideration.¹⁷ However, there has been some pushback from other courts over whether two years should be the bright line standard.¹⁸

The state's desire to legislate the prohibition of non-compete agreements with low-wage workers seemed to take off following a 2016 lawsuit in which the Illinois Attorney General, Lisa Madigan, sued Jimmy John's over the corporation's enforcement of non-compete agreements with nearly all of its departing employees, including with its lowest level employees such as sandwich makers and delivery drivers.¹⁹ The agreements in dispute prohibited the employees, during and for two years after their employment, from working for any business located within two miles of any Jimmy Johns location anywhere that derives at least 10% of its revenue from selling sandwiches.²⁰ In its complaint, the Attorney General argued that Jimmy Johns had no "legitimate business interest" in imposing this particular restraint on shop employees and assistant managers, and that "the majority of individual signatories to these agreements unaware that the non-competition agreements are illegal and unenforceable and will continue to suffer economic harm as a result."²¹ The two sides ultimately reached a pre-trial settlement that required that Jimmy Johns to promise to notify all current and former employees that their non-competes are void, and also promise that all future non-competes agreements with its employees will be based a "legitimate" and "narrowly tailored" business interest."²² Regardless of the promises secured from Jimmy Johns, the legislature wanted to make sure similar unreasonable agreements with low-wage employees would no longer occur

¹⁷ *Fifield v. Premier Dealer Servs., Inc.*, 993 N.E.2d 938, 942 (Ill. App. 1st 2013).

¹⁸ *Misichko*, *supra* note 4, at 35.

¹⁹ Complaint, *Illinois v. Jimmy John's Enterprises*, No. 2016-CH-07746 (Ill. Cir. Ct. June 8, 2016).

²⁰ *Id.* at 2.

²¹ *Id.* at 4.

²² Daniel Wiessner, *Jimmy John's settles Illinois lawsuit over non-compete agreements*, REUTERS (Dec. 7, 2016, 12:55 PM), <https://www.reuters.com/article/us-jimmyjohns-settlement/jimmy-johns-settles-illinois-lawsuit-over-non-compete-agreements-idUSKBN13W2JA>.

statewide going forward.²³ As a result, the Illinois General Assembly moved quickly to enact the Work Act in August of 2016, less than a month after the Attorney General's Office formally announced its settlement agreement with Jimmy Johns.²⁴

The Act prohibits employers from entering into covenants not to compete with low-wage employees, which the state defines as a private sector employee who makes either (a) the federal, state, or local minimum wage or (b) \$13.00 per hour or less.²⁵ The statute defines a "Covenant not to compete" as "an agreement:

(1) between a [private sector] employer and a low-wage employee that restricts such low-wage employee from performing: (A) any work for another employer for a specified period of time; (B) any work in a specified geographic area or; (C) work for another employer that is similar to such low-wage employee's work for the employer included as a party to the agreement; and (2) that is entered into after [January 1, 2017].²⁶

Thus, when the Act went into effect, it meant that fulfilling the common law elements of an enforceable restrictive covenant was no longer sufficient in itself to uphold non-compete agreements between employers and low-wage workers in Illinois.²⁷

The legislature's enactment of the Work Act is reflective of an initiative by policymakers nationwide to ensure that employers are not placing unreasonable restraints on the mobility of low-wage workers or abusing non-compete agreements. In accordance with this position, the White House published a report in May of 2016 detailing the benefits and harm created through non-compete agreements.²⁸ The report in part concluded that, while non-competes can sometimes be beneficial when they are an appropriate means of protecting an

²³ Jenna Brownlee and Catilin Kelly, note, *Recent Development: To Compete or Not to Compete: Illinois' Movement to Eliminate Noncompete Agreements*, 48 LOY. U. CHI. L.J. 1233 (2017).

²⁴ Salvatore, *supra* note 1.

²⁵ *Id.*

²⁶ Illinois Freedom to Work Act, Ill. SB 3163 (2015)

²⁷ Illinois Freedom to Work Act, 820 ILL. COMP. STAT. 90/1 (2017)

²⁸ NON-COMPETE AGREEMENTS: ANALYSIS OF THE USAGE, POTENTIAL ISSUES, AND STATE RESPONSES, THE WHITE HOUSE (2016), https://obamawhitehouse.archives.gov/sites/default/files/non-competes_report_final2.pdf

employer's trade secrets or protecting investments in employee training, they often times create an unreasonable restraint on job mobility, prevent departed employees from finding subsequent employment elsewhere, and preventing workers using the prospect of taking another job as leverage when bargaining for better terms.²⁹ The report also argues that non-competes can result in general economic harm by shrinking the labor pool of qualified candidates for other companies and discouraging innovation. To go along with the White House's 2016 report, the U.S. Department of Treasury issued a report of their own two months earlier, concluding that while non-compete agreements can provide "important social benefits" in some situations, "many of these benefits come at the expense of workers and the broader economy."³⁰

III. ANALYSIS

When it comes to non-competes for low-wage workers, the reasoning to prohibit them altogether makes added sense since the risk of potential harm to employees often goes up while the chances of an agreement serving a legitimate business interest go down. To that end, those in favor of banning non-competes altogether with low-wage employees could point to the White House's finding in their 2016 report that "[f]ourteen percent of workers earning \$40,000 or less have signed non-competes, although those workers possess trade secrets at less than half the rate of their higher-earning counterparts."³¹ Additionally, the harm that non-competes can cause by preventing departing employees from finding new employment becomes even more significant for low-wage employees who lack marketable skills outside their employment area, and therefore would have decreased chances of finding a job in an alternative field.³²

Thus, undoubtedly, there are a number of legitimate policy reasons that justify the Illinois General Assembly's interest in reforming the state's

²⁹ *Id.* at 2.

³⁰ U.S. DEP'T. OF TREASURY, *supra* note 8, at 3

³¹ THE WHITE HOUSE, *supra* note 28, at 8.

³² *Id.*

enforceability rules for non-compete agreements with low-wage employees. However, while there is little disputing that regulating the enforceability of non-compete agreements is a valuable and arguably necessary tool that state legislature can use to prevent companies from abusively using non-compete agreements and to protect vulnerable workers from restraints on employment, it also does not necessarily follow that uniformly prohibiting all non-compete agreements with low-wage employees is the most optimal use of that tool. Although many, if not most, non-compete agreements with low-wage workers do not relate to a “legitimate business interest,” it’s also likely true that are at least some that do.³³ Additionally, while the White House report stated that fourteen percent of workers making \$40,000 annually or less accrue trade secrets far less frequently than higher-paid workers, that also doesn’t mean that such a thing never happens.

Consider, for example, if a small public relations firm hired a college student as a summer intern, and agreed to pay that intern a minimum wage salary, which compared to the zero salary many student interns receive, seems agreeable to the intern. Then, for three months, the employer trains the intern on how to follow their unique business model and tasks the intern with constantly engaging with a set of clients in efforts to promote their brand. In that situation, it seems reasonable that the employer may want to use a non-compete agreement to protect itself from that intern taking in the valuable training and knowledge of the firm’s client base, and then departing to make use of that information with a competitor.

Before 2017, as long as this agreement was ancillary to the original employment agreement and supported by adequate consideration, an Illinois state court prior to 2017 would have had the ability to uphold agreements with low-wage employees, assuming it met the common requirements.³⁴ And now, in those rare cases where an employer could plausibly convince a court that it had a “legitimate business interest” in imposing an employment restraint on a low-wage employee, the Work Act would automatically bar them from doing so. As a result,

³³ *Reliable Fire Equip. Co. v. Arredondo*, 965 N.E.2d 393 (Ill. 2011).

³⁴ *Misichko*, *supra* note 4, at 35.

one could argue that the Act creates the risk of prohibiting certain agreements with low-wage workers that would be deemed reasonable based on common law principles for the purpose of deterring unreasonable ones.

Nonetheless, policymakers would likely respond to that critique by arguing that, even if courts would likely throw out a majority of non-compete agreements with low-wage workers, many of the employees affected by these agreements would be unlikely to realize that they would not likely hold up in court, or would prefer to not resort to taking legal action for various reasons. Additionally, companies might be less willing to try to effectuate these types of agreements if they are statutorily banned as opposed to just deterred by common law precedent that suggests the agreements would not hold up in court. Thirdly, forcing employees to take their dispute to court in order get it thrown out could likely further clog the court system and disadvantage employees who have limited funds available to hire legal representation. Finally, even if employers are unable to use non-compete agreements to protect their trade secrets, employers can also gain protection through Illinois state laws that impose liability on employees who “misappropriate” the employer’s trade secrets.³⁵

Those protections, however, do not protect the employer when the trade secret was acquired in a legitimate manner.³⁶ Thus, even if an employer still has option of suing, being able to prove that an employee violated trade secret laws is almost always costly and hardly ever a sure thing, making it reasonable to understand why an employer may want to use a non-compete agreement to protect itself from that risk in the first place. Additionally, if a major reason why Illinois still bans non-competes for low-wage workers even though they rarely hold up in court anyway is to prevent excessive litigation and disadvantaging employees who cannot pay for litigation, the same logic should apply for the small subset of employers who have a legitimate business interest in using a non-compete with a low-wage worker, and would prefer that litigation is not their only means of ensuring the protection of their trade secrets.

³⁵ Littler, *supra* note 16, at 1.

³⁶ *Id.*

As for how the Act as currently constructed stands to impact companies going forward, many companies will either have to abandon their use of non-compete agreements with low-wage workers altogether or start paying those workers more than \$13 dollars an hour so that they can still enter into enforceable agreements with them. Those are unquestionably positive outcomes in the eyes of many citizens of Illinois. However, by making the ban of non-competes with low-workers absolute, there is also a possibility that it could lead to some negative consequences. For example, instead of choosing to pay an employee more, the ban on non-competes could potentially persuade some employers not to hire as many employees.³⁹ As an additional alternative to paying low-wage workers more, some employers may also choose to invest less resources in training low-wage employees and no longer entrust them with secrets and confidential information that could provide opportunities for enhanced growth within the company.³⁷

IV. RECOMMENDATION

In all likelihood, the Work Act seems to do more harm than good for the people of Illinois. However, this note is optimistic that there may be a way to improve the statute to diminish the potential harm without diminishing any of the good that conceivably brings. In that sense, one possible solution to the Work Act casting slightly too wide of a net through the nondiscretionary scope of the statute would be to amend the statute to allow for a small set of narrowly-defined exceptions when a non-compete agreement with a low-wage worker may be enforceable. In that sense, Illinois would be following the blueprint of the statute that the state of Colorado has in place for all non-compete agreements in general.³⁸ Under Colorado's statutory rule, non-compete agreements are generally

³⁹ Jonathan Macey, *Obama's Pitch to Ban Non-Competes Would Make the Rich Richer*, FORTUNE (Nov. 4, 2016), <http://fortune.com/2016/11/03/obama-non-compete-agreements/>.

³⁷ *Id.*

³⁸ COLO. REV. STAT. § 8-2-113 (2017).

unenforceable – unless they fall under one of the statute’s four specifically listed exceptions, which are for:

- (a) Any contract for the purchase and sale of a business or the assets of a business; (b) Any contract for the protection of trade secrets; (c) Any contractual provision providing for recovery of the expense of educating and training an employee who has served an employer for less than two years; and (d) Executive and management personnel and officers and employees who constitute professional staff to executive and management personnel.³⁹

Something that Colorado’s statute does well is that it seeks to eliminate much of the harm that can take place when companies abuse non-compete agreements while also preserving some of the key benefits that can result from ability to sign an employee to a restrictive covenant. Specifically, two central benefits listed by the White House and U.S. Treasury in their respective reports were the ability to protect trade secrets and the ability to protect companies from wasting valuable resources on training an employee that ends up departing soon thereafter.⁴⁰ In that sense, Colorado’s statute takes the approach that legislating the enforceability of non-competes does not have to be a zero sum game where eliminating harm and preserving certain benefits are mutually exclusive.⁴¹ Since every state has different needs and circumstances, and since the Illinois Freedom to Work Act only pertains to low-wage employees as of now, amending the Act to follow the Colorado blueprint wouldn’t necessarily mean that the exceptions accompanying the Illinois’ statute would be the same as the ones in the Colorado statute. Nonetheless, legislators could still look to the exemptions Colorado has put in place as a general baseline to start out with in terms of what has worked elsewhere.

³⁹ *Id.*

⁴⁰ THE WHITE HOUSE, *supra* note 23, at 8; U.S. DEP’T. OF TREASURY, *supra* note 8, at 3.

⁴¹ Norman Bishara, *Covenants Not To Compete in a Knowledge Economy: Balancing Innovation from Employee Mobility Against Legal Protection for Human Capital Investment*, 27 BERKELEY J. EMP. & LAB. L. 287 (2006)

Even so, proponents of keeping the Work Act as is may argue that adding specific exceptions when non-competes with low-wage workers may be enforceable would essentially cripple the statute's ability to actually accomplish its policy objectives. For example, if one of the exceptions that Illinois added to the Act was for "Any contract for the protection of trade secrets," one could argue that it would make it too easy for employers to claim one of these exceptions, which bring back the same problem the state had before of companies overusing non-compete agreements. The legislators could largely prevent that issue by defining the exceptions very specifically so as to not create a wide umbrella under which employers can claim that the Work Act does not apply to them.

In defining these exceptions, legislators could look to the White House and U.S. Treasury 2016 reports that list instances when non-competes can provide social benefits, as well as consulting Illinois common law precedent when courts have found legitimately reasonable uses of non-compete agreements between employers and low-wage employees.⁴² One of those exceptions could include situations where the employee engages heavily with client and makes constant use of the employer's confidential information regarding those companies, which was the basis for the Appeals Court of Illinois upholding a particular agreement during a case in 1993.⁴³

Even if making these exceptions highly specific still leaves open some possibility of nullifying some agreements that would be reasonable under common law standards, that occurrence would now at least happen less often than it would have before. Hence, amending the Work Act to allow for certain highly specific exceptions when employers could enter into enforceable non-compete agreements with low-wage employees would shrink the gap between the legislatures approach to what agreements would be enforceable and the approach of Illinois common law toward what should be enforceable, while still keeping the "teeth" of the Act intact.

⁴² THE WHITE HOUSE, *supra* note 23, at 8; U.S. DEP'T. OF TREASURY, *supra* note 8, at 3.

⁴³ Lyle R. Jager Agency v. Steward, 625 N.E.2d 397, 403 (Ill. App. 3d 1993)

V. CONCLUSION

For decades, Illinois state courts had the exclusive task of determining whether individual non-compete agreements were enforceable. That all changed in August 2016 when the Illinois General Assembly enacted the Work Act, which prohibits non-compete agreements with private sector employees making less than \$13 per hour altogether.⁴⁴ The policy reasons for invoking the Act are undoubtedly sound and rooted in an effort to prevent employers from taking advantage of vulnerable employees through unreasonably restrictive agreements.⁴⁵ However, banning these agreements with low-wage workers without any room for exception runs the risk of unnecessarily nullifying some agreements that actually are backed by a “legitimate business interest” and do not impose unreasonably restrictive restraints.⁴⁶ By incorporating a set of highly-specific, limited exceptions where a non-compete agreement with a low-wage could still be enforceable, as Colorado has done with their non-compete legislation across the board, the Illinois General Assembly could ensure a nearly identical level of protection for workers while also reducing instances where a business is flatly denied the opportunity to use a non-compete agreement despite having a uniquely legitimate reason to.

⁴⁴ Illinois Freedom to Work Act, Ill. SB 3163 (2015).

⁴⁵ Brownlee and Kelly, *supra* note 25, at 1248.

⁴⁶ COLO. REV. STAT. § 8-2-113 (2017).