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Washington State Adopts Legislation Restricting Noncompetition Agreements

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Finding that “workforce mobility is important to economic growth and development” and that “agreements limiting competition or hiring may be contracts of adhesion that are unreasonable,” the Washington State legislature enacted a new law that significantly restricts the use of employment-related noncompetition covenants and agreements. In summary:

- The law makes noncompetition covenants in any professional, trade, or business contract “void and unenforceable” against: (1) employees to whom an employer does not provide in writing the terms of the covenant before the employee’s acceptance of an offer of employment; (2) employees who earn less than $100,000 per year on an annualized basis from the party seeking enforcement of the covenant; (3) independent contractors who earn less than $250,000 per year from the party seeking enforcement; and (4) employees who are terminated due to a layoff, unless the employee is compensated for the period of enforcement minus compensation otherwise earned by the employee during the period of enforcement. The relevant dollar thresholds are subject to an annual inflation adjustment.
- The law creates a rebuttable presumption that a noncompetition covenant longer than 18 months is unreasonable and unenforceable.
- The law does not bar non-solicitation agreements, confidentiality agreements, or non-competes entered into in connection with the sale of the goodwill of a business or an ownership interest.

This alert discusses the basic provisions and some of the complexities of the new law, which takes effect on January 1, 2020. The law includes confusing language as to whether agreements entered into before January 1, 2020, are subject to the law, and there is some uncertainty about the intent of the law’s retroactivity language.

Key Definitions

The law is built around a series of key definitions:

“Noncompetition covenant” includes every written or oral covenant, agreement, or contract by which an employee or independent contractor is prohibited or restrained from engaging in a lawful profession, trade, or business of any kind.

A noncompetition covenant does not include: (a) a nonsolicitation agreement with respect to employees or customers of the employer; (b) a confidentiality agreement; (c) a covenant prohibiting use or disclosure of trade secrets or inventions; (d) a covenant entered into by a person purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest; or (e) a covenant entered into by a franchisee when the franchise sale complies with applicable Washington law.

- *Practice Note: It is unclear whether subsidiaries or affiliates of the employer are included in the nonsolicitation carve out.*

"Earnings" means the compensation reflected on box one of the employee's United States Internal Revenue Service form W-2 that is paid to an employee over the prior year, or portion thereof for which the employee was employed, annualized, and calculated as of the earlier of the date enforcement of the noncompetition covenant is sought or the date of separation from employment. "Earnings" also means payments reported on Internal Revenue Service form 1099-MISC for independent contractors.

- *Practice Note:*
  - *Because the definition of earnings generally reflects W-2 income, stock options and similar equity awards do not appear to constitute an "ownership interest" that precludes application of the law.*
  - *The "earnings" definition and the earnings threshold make no adjustment for part-time employment.*

"Party seeking enforcement" means the named plaintiff or claimant in a proceeding to enforce a noncompetition covenant or the defendant in an action for declaratory relief.

- *Practice Note: In context, this means an employer suing to enforce a noncompetition covenant, or an employer being sued by a current or former employee seeking to have a court declare that the covenant is not enforceable*.

Key Provisions

Under the new law, a noncompetition covenant is void and unenforceable against an employee or, as applicable, an independent contractor:

- Unless (1) the employer discloses the terms of the covenant in writing to the prospective employee no later than the time of the acceptance of the offer of employment, and (2) if the agreement becomes enforceable only at a later date due to changes in the employee's compensation, the employer specifically discloses that the agreement may be enforceable against the employee in the future;
- If the covenant is entered into after the commencement of employment, unless the employer provides independent consideration for the covenant.
  - *Practice Note: One strategy that employers may want to consider is to enter into noncompetition agreements with all employees reasonably anticipated, at the time of employment, to have earnings potential of more than $100,000 (as adjusted), but provide that the covenant becomes enforceable only at the time the earnings requirement is met. However, it is unclear as to whether additional consideration would be required at the time that the earnings threshold is met in order for the agreement to be enforceable. Seemingly, an increase in base compensation should*

generally satisfy any additional consideration requirement. But, for example, if the compensation threshold is reached through an annual bonus that is not given the next year, employers should be concerned about whether the threshold is no longer met.

- Unless the employee's earnings from the party seeking enforcement, when annualized, exceed $100,000 per year. The Washington Department of Labor and Industries (L&I) will adjust this dollar amount annually for inflation;
- If the employee is terminated as the result of a layoff, unless enforcement of the noncompetition covenant includes compensation equivalent to the employee's base salary at the time of termination for the period of enforcement minus compensation earned through subsequent employment during the period of enforcement; and
    - *Practice Notes:*
        - *If a former employer elects to pay for this equivalent of "garden leave ," how would the former employer know if it could reduce its payments during the period of enforcement, absent monitoring and perhaps monthly representations and warranties by the former employee as to any new employment or compensation?*
        - *The "period of enforcement" is not defined, rendering the section ambiguous. It is unclear whether this means that an employer could begin paying garden leave upon layoff for a 12-month noncompetition period, but later opt out of such payments in lieu of enforcing the non-compete for the remaining term.*
- Unless the independent contractor's earnings from the party seeking enforcement exceed $250,000 per year. L&I will also adjust this dollar amount annually for inflation.
    - *Practice Notes:*
        - *While it is beyond the scope of this alert to discuss misclassification risks, if an independent contractor is subjected to a non-compete, the non-compete is a factor that may impact any misclassification analysis.*
        - *Unlike the definition of "Earnings" for employees, the $250,000 threshold for independent contractors is not annualized.*

Additionally, by way of key highlights:

- A franchisor may not restrict, restrain, or prohibit a franchisee from soliciting or hiring an employee of a franchisee of the same franchisor or any employee of the franchisor;
- A provision in a noncompetition covenant signed by an employee or independent contractor who is "Washington-based" is void and unenforceable if it requires adjudication of the noncompetition covenant outside of Washington or to the extent it deprives the employee or independent contractor of the protections or benefits of the legislation;
    - *Practice Note: The term "Washington-based" is not defined but arguably could apply to employees of Washington-based employers, employees who are assigned to an office or location in Washington, or employees who spend a substantial amount of work time in Washington.*
- A court or arbitrator must presume that any noncompetition covenant with a duration of 18 months or more after termination of employment is unreasonable and unenforceable. A party seeking enforcement may rebut the presumption by proving by clear and convincing evidence that a duration longer than 18 months is necessary to protect the party's business or goodwill;
- Employers may not restrict an employee earning less than twice the applicable state minimum hourly wage ($13.50 per hour as of January 1, 2020) from having another job, working for another employer, working as an independent contractor, or being self-employed, unless such additional services (1) raise issues of safety for the employee, co-workers, or the public, or (2)

interfere with reasonable and normal scheduling expectations of the employer;
    - *Practice Note: There is no prohibition on an employee working for a competitor.*
- The new law generally displaces conflicting tort, restitutionary, contract, and other Washington laws pertaining to liability for competition by employees or independent contractors with their employers or principals, as appropriate. On the other hand, the law is not intended to revoke, modify, or impede the development of the common law.
    - *Practice Note: These provisions generally leave unclear the impact of the legislation on the common law duty of loyalty of employees and Washington law that has previously allowed courts to modify or reform non-compete clauses to render them enforceable (a so-called "blue pencil" clause).*

Effectiveness and Retroactivity

The law becomes effective as of January 1, 2020. By its terms, however, the law applies to all proceedings commenced on or after January 1, 2020, regardless of when the cause of action arose. To this extent, the law applies retroactively. In addition, the law provides that an action may not be brought on a noncompetition covenant signed prior to January 1, 2020 unless that noncompetition covenant is being enforced; what is meant by "being enforced" is not clear. In any event, it is possible that these retroactive provisions might be challenged under provisions of the U.S. Constitution that bar states from passing laws that impair the obligations of contracts.

Consequences for Violations

Persons who believe they are subject to a noncompetition agreement in violation of this new law may bring a cause of action, or the Attorney General may bring such an action on behalf of one or more persons. If the relevant court or arbitrator finds a violation of the new law, the violator must pay the higher of the actual damages or a statutory penalty of $5,000 plus reasonable attorneys' fees and related costs and expenses. This mandatory obligation to pay also applies if a court or arbitrator reforms, rewrites, or only partially enforces the noncompetition agreement.

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