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Part 23 of “The Restricting Covenant” Series: Legislative Limitations

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This latest installment of The Restricting Covenant series highlights the significant changes coming to Washington State regarding non-compete agreements (it’s a game changer), as well as similar legislation (passed and proposed) in other states including Massachusetts and New Jersey. Employers surely will feel the ripple effect of Washington’s new sweeping law on non-competes. Is this a sign of things to come for significant non-compete reform in other states coast to coast (“Winter is Coming,” anyone?).

What’s All the Fuss About in Washington State?

Private employers and employees have been entering into non-compete agreements for hundreds of years dating back to English common law. In Washington, like many other states, the rules for the what, when, who, where, and why of non-competes largely were developed over time by state and federal judges on a case-by-case basis. Lawmakers historically stayed out of this realm of contracts law. But, to quote Bob Dylan: “The Times They Are a-Changin.” At least, in Washington they are.

Starting January 1, 2020, the ground rules for the formation, scope and enforceability of non-compete agreements for Washington-based employees and independent contractors will change quite dramatically from the status quo. That’s when Washington’s new non-compete law becomes effective. The Legislature’s rationale for passing this law was two-fold: (1) “workforce mobility is important to economic growth and development”; and (2) “agreements limiting competition or hiring may be contracts of adhesion that may be unreasonable.” The law specifically states that it was passed as “an exercise of the state’s police power and shall be construed liberally for the accomplishment of its purposes.” Until now, I had never associated non-competes with a state’s “police power.”

With a few notable exceptions, the Washington law defines “noncompetition covenants” very broad to include “every written or oralcovenant, agreement, or contract” by which any “employee or independent contractor” is prohibited or restrained from “engaging in a lawful profession, trade, or business of any kind.” These words are emphasized to highlight the breadth of the law. The silver lining for employers is that the exceptions include: (1) non-solicitation, (2) confidentiality and (3) non-disclosure of trade secrets and inventions agreements, (4) sales of business, and (5) sale of franchise agreements. Here are some of the most significant aspects of the

new law:

#1: All Employees and Independent Contractors. The law applies to any employee or independent contractor regardless of industry, trade, job type, or profession. Nuff said!

#2: Minimum Salary Thresholds. For a large group of Washington-based employees and independent contractors, non-compete agreements will go the way of the Dodo bird. Non-competition agreements will be unenforceable in Washington unless the employee earns more than $100,000 annually, or the independent contractor earns more than $250,000 annually. Both of these salary thresholds will be adjusted annually for inflation.

#3: Limits on Duration. A restriction longer than 18 months is presumed to be "unreasonable and unenforceable." A party seeking to enforce restrictions exceeding 18 months must prove by "clear and convincing" (*i.e.*, a high standard) that beyond 18 months is "necessary to protect the party's business or goodwill."

#4: Garden Leave for Layoffs. If an employee is terminated as part of a "layoff" (undefined), the non-compete will not be enforceable unless the covenant includes "compensation equivalent to the employee's base salary at the time of termination minus compensation the employee earned through subsequent employment during the period of enforcement."

The law does not address some of the practical issues associated with this garden-leave structure. For example, when does the employer have to provide the "equivalent compensation" to the employee – when the enforcement starts, ends, or periodically during enforcement? Is there a "true up" between the employer and former employee at the end of the enforcement period to account for any income the former employee earned through subsequent employment? Can the employer compensate the employee with something other than cash, like fringe benefits, stock or other equity? Can the employer reduce the enforcement period to reduce the total amount of compensation to the employee? Perhaps Washington's Department of Labor will issue a "FAQ" answering these questions.

#5: Written Notice Requirement. The employer must disclose the terms of the non-compete, in writing, to prospective employees before the employee accepts an offer of employment. This prevents situations where the employee would accept an offer, and then be presented with a non-compete for the first time during the onboarding process or later.

#6: Additional Consideration Requirement. A non-compete will not be enforceable if it is entered into after employment starts unless the employer provides "independent consideration" (undefined). This requirement appears to codify what some Washington courts had already held was required when an employer asks an employee to sign a non-compete after employment starts, or when the employer materially changes the restrictions during employment.

#7: A Ban on Franchisor No-Hire and Non-Solicits with Franchisees. A franchisor cannot prohibit a franchisee from soliciting or hiring a franchisor's employee or any employee of a franchisee of the same franchisor. In other words, a franchisor cannot have a no-poach agreement with its franchisees. This change likely stems from the recent wave of state and federal government enforcement actions targeting use of no-poach agreements involving low-wage workers. See Part 22 of the "The Restricting Covenant" series.

#8: No Waiver of Venue/Jurisdiction. An employer cannot require a Washington-based employee

or independent contractor to litigate a non-compete agreement outside of Washington or otherwise deprive them of the protections or benefits of the Washington non-compete law. Therefore, out-of-state employers that have non-competes with any Washington-based employees or independent contractors should review their forum selection and choice of law provisions to ensure compliance since many companies with employees in different states have a single choice of law and venue location in their non-compete agreements.

#9: Moonlighting Is Permitted in Some Situations*.* An employer cannot prohibit an employee who earns less than twice the Washington State minimum wage from working a second job or otherwise supplementing their income with another employer or as an independent contractor. However, the law reaffirms that an employee continues to owe the employer a common law "duty of loyalty."

#10: Enhanced Legal Remedies and Penalties. The Washington Attorney General can bring a lawsuit on behalf of an aggrieved person, or the aggrieved person can bring a private lawsuit. If a court or an arbitrator finds a violation of the law, the violator must pay the aggrieved person the greater of (a) his or her actual damages, or (b) a statutory penalty of $5,000, plus reasonable attorneys' fees, expenses and costs incurred in the proceeding. Also, if a court or an arbitrator "reforms, rewrites, modifies, or only partially enforces any noncompetition covenant," the party seeking enforcement must pay the aggrieved person the greater of (a) his or her actual damages, or (b) a statutory penalty of $5,000, plus reasonable attorneys' fees, expenses and costs incurred in the proceeding.

The remedies provision in Washington's new law is unique and significant for any employer considering a non-compete enforcement action for Washington-based employees or independent contractors. If, for example, a judge or an arbitrator were to decide that the restrictions were enforceable but overbroad and "blue-pencil" them to make them reasonable and enforceable, the employer could be required to pay a $5,000 penalty or actual damages if greater, plus reasonable attorneys' fees. The attorneys' fees clause, alone, will give employers reason to pause before deciding whether to file an enforcement action in Washington. There are some other quirky aspects of the law, including a very specific provision that performers and performance spaces' non-competes cannot exceed three days, but more significantly some unclear language regarding the retroactive application of this law to existing non-compete agreements.

Will Other States Enact Similar Non-Compete Reform Laws?

In October 2018, Massachusetts lawmakers enacted a comprehensive non-compete agreement reform law. The Massachusetts "Noncompetition Agreement Act" applies to employees and independent contractors who are Massachusetts-based, and employers cannot circumvent the new law by including a different state's choice of law provision. Other significant aspects of the Massachusetts law is its "garden leave" requirement. Employers are required to pay employees for the duration of the non-compete period at least 50% of the employee's highest salary within the last two years of employment. It also bans non-competes with employees who are classified as "non-exempt" under the Fair Labor Standards Act ("FLSA"), and it renders unenforceable any non-compete with employees terminated "without cause" or laid off.

Other states, including New Jersey, Pennsylvania and Vermont, have proposed legislation that would either ban non-competes almost entirely or significantly curtail their scope and enforceability. For example, earlier this year, the Vermont Legislature proposed a bill that would ban all non-competes with some limited exceptions. Similarly, Pennsylvania's proposed "Freedom to Work Act" would ban non-competes except for a few exceptions like sale of a business.

The New Jersey Legislature's latest iteration of non-compete reform was introduced by the Senate (S2872) and the Assembly (A1769) in August 2018. The proposed law would set forth a 10-prong test to determine enforceability of a non-compete, including temporal and geographic limitation requirements. It also would ban non-competes for a wide variety of workers, including any employee classified as "nonexempt" under the FLSA, seasonal or temporary employees, independent contractors, paid and unpaid interns, minors under the age of 18, employees terminated "without a determination of misconduct or laid off by action of the employer," and employees whose period of service to an employer is less than one year. Additionally, similar to Washington's and Massachusetts non-compete laws, New Jersey's proposed law would require the employer to pay the employee during the enforcement period, and goes further by requiring 100% matching of compensation and benefits during the enforcement period.

Finally, let's not leave out our federal lawmakers. In 2018, Senators Elizabeth Warren (D-MA), Ronald Wyden (D-OR), and Christopher Murphy (D-CT) introduced Senate Bill 2782, titled "the Workforce Mobility Act of 2018," which seeks to prohibit companies engaged in interstate commerce from requiring its employees to sign a covenant not to compete. In January 2019, Senator Marco Rubio (R-FL) introduced Senate Bill 124, titled "the Freedom to Compete Act," which would amend the FLSA to prevent employers from using non-compete agreements in employment contracts for certain "non-exempt" employees.

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The goal of this Series is to provide a brief overview and some interesting insights and practical pointers when dealing with unique issues that might arise in the context of restrictive covenants. It is not intended to provide and should not be construed as providing legal advice. Each situation is different, including the governing state law. If legal advice is needed, you should seek the services of a qualified attorney who is knowledgeable and experienced in this area of the law to address your specific issues or needs.

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