

Noncompete Agreements Under Siege At The State Level

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Compared with many other areas of labor and employment law, the law of noncompetition agreements has been relatively static with most changes coming in the form of court decisions addressing particular cases. More recently, however, legislatures in many states have turned their attention to noncompetition agreements and considered significant procedural and substantive changes in how noncompetition agreements are used and enforced. Employers will need to stay abreast of this changing area of law and ensure that employment contracts are updated to keep pace with new developments, as the consequences of being unable to enforce a restrictive covenant against a departing key employee can be devastating and costly.

Noncompetition agreements, also known as “covenants not to compete” or “restrictive covenants,” have long been a controversial part of employment law, as countless judicial opinions nationwide have debated the circumstances under which these post-employment restrictions may be enforced. While employers rely on these agreements to protect their trade secrets and customer goodwill, many employees maintain that noncompetition agreements limit their ability to advance their careers within their field of choice, restrain wage growth and prevent them from earning a living. Given this controversy, and the fact that recent research suggests that as much as 18 percent of the American workforce may be covered by a noncompetition agreement, it is perhaps surprising that the law’s development in this area has occurred mainly through the common law, without legislative intervention in most jurisdictions.

Recent developments show that the relative legislative inattention toward noncompetition agreements is a thing of the past. In its final year, the Obama administration began a push to create momentum for widespread regulation of the use of noncompete agreements. This push began in March 2016 with the publication of a white paper on the economic effects of noncompete agreements by the U.S. Department of the Treasury's Office of Economic Policy, which was followed in May 2016 by a White House report on the subject. In the waning days of President Barack Obama’s second term in office, on Oct. 25, 2016, the White House released a “call to action” imploring states to take action to curtail the usage of noncompete agreements, including by prohibiting such agreement for certain categories of workers, increasing transparency by imposing notice and other procedural requirements, and eliminating the ability of courts to reform overbroad agreements.



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The Obama administration's late push on noncompete agreements may have been motivated by the assumption that an ideologically consistent Hillary Clinton administration would continue the effort after the 2016 election. As is the case with many other labor and employment law areas, President Donald Trump's surprise election appears to signal an end to any federal push for increased regulation of noncompetition agreements. While Trump has not issued any public statement or position on the use of these agreements, he has broadly promised to usher in a deregulatory agenda in labor and employment law and other areas.

With further federal action presumably a nonstarter, many states have picked up the baton. 2016 saw a handful of states pass legislation limiting the use of noncompetition agreements. So far in 2017, that trend has gained steam with over a dozen states introducing measures to constrain enforcement of restrictive covenants. As might be expected, the types of measures introduced are as varied as the states themselves, and the prospects for success of any given measure depend on a variety of nuances of states politics that are beyond the scope of this article.

Despite a lack of uniformity in the different state legislative proposals, there are several broad trends in the recent state noncompetition agreement legislation, many of which echo proposals made by the Obama administration. These trends are as follows:

Complete Prohibitions on Enforcement: The most extreme legislative proposals that have been offered prohibit the enforcement of noncompetition agreements. Legislation to this effect has been introduced in Massachusetts, Oregon and Missouri, but has not made significant legislative progress in any of these states. If these measures are enacted, these states would join California, North Dakota and Oklahoma in prohibiting the enforcement of noncompetition agreements against the great majority of employees.

Industry-Specific Prohibitions: While not prohibiting noncompetition agreement enforcement generally, other states have passed or introduced legislation targeting enforcement in specific industries where free competition is deemed to be in the public interest. Frequently, these measures involve the medical field where restrictive covenants are widespread as states seek to ensure that patients retain access to their health care professional of choice.

Last year, Rhode Island enacted legislation that largely rendered physician noncompetition agreements void and unenforceable, and Connecticut imposed new limits on when and to what extent physician noncompetition agreements may be enforced. In 2017, this trend has continued, with West Virginia enacting a new statute limiting the enforcement of noncompetition agreements against physicians. Measures have also been introduced recently in Pennsylvania, Minnesota, Oregon (home care workers), New Mexico (certified nurse practitioners and midwives), and Connecticut (homemakers, companions and home health aides) that target noncompete enforcement against physicians and others in the health and medical profession.

The medical field is not the only one that has been targeted. In 2015, Hawaii passed legislation voiding noncompete and nonsolicitation clauses imposed by employers in the information technology industry. Other states have targeted job classes as varied as insurance agents (Minnesota) and broadcasting employees (Ohio).

Low-Wage Employees: Many opponents of noncompete agreements have focused on the application of such agreements to low-wage employees, who they argue lack the trade secrets, specialized skills or customer goodwill that typically justify the enforcement of noncompetes. In one well-publicized case,

the attorneys general of Illinois and New York investigated sandwich chain Jimmy John's for its use of post-employment restrictions in contracts with in-store employees, including sandwich makers. In 2016, Illinois codified this opposition by passing its Freedom to Work Act barring noncompete enforcement against employees making less than \$13.00 per hour. This year, several states, including Massachusetts, Maine, Maryland (where the legislation did not pass) and Washington, have considered income-based restrictions on the enforcement of noncompetition agreements. Washington proposed highest income threshold for enforceability, as legislation under consideration there prohibits enforcement against employees making less than \$55,000 per year.

Involuntary Termination Restrictions: Some consider it unfair for employers to enforce noncompete agreements against employees who have been involuntarily terminated without cause by the employer. Indeed, courts in several states already refuse to enforce noncompetition agreements under such circumstances as a matter of common law. Now, certain jurisdictions are attempting to codify this restriction. States in which pending legislation seeks to prohibit employers from enforcing noncompetes against employees terminated without cause include Massachusetts, New York and Minnesota. A pending New Jersey measure would have a similar effect by denying enforcement against persons found eligible to receive unemployment benefits. Finally, the enacted West Virginia statute limiting enforcement against physicians would also void any noncompetition clause in the event that an employer terminated the physician's contract prior to its expiration date.

Notice Requirements: Another common proposal has been to require that employers notify job applicants and employees at early stages in the hiring process that they will be required to sign a noncompetition agreement. The rationale for these notice requirements is that a prospective employee has more leverage to negotiate with the employer before the employee has accepted an offer of employment and left his or her previous job. Once the employee has already committed to change jobs or started a new job, however, the ability to refuse to sign a noncompete or negotiate the noncompete's terms may be greatly diminished.

Proposed legislation in Maine requires employers to state in the initial job listing that a position is subject to a noncompetition agreement and disclose a copy of the agreement no later than three business days before it is signed. A Washington measure requires that the terms of the noncompete be disclosed at the time that an offer of employment is made. Massachusetts would require that the employee be provided with the noncompetition agreement at the earlier of the time a written offer of employment is made, or two weeks before commencing employment. The pending Massachusetts legislation also imposes a novel post-employment notice requirement, as employers would be required to notify departing employees by certified mail within 10 days of termination that it intends to enforce its noncompete agreement. An employer's failure to provide the post-termination notice results in the waiver of any claim for breach of the noncompetition agreement in many circumstances.

Independent Consideration Requirements: Another way in which states have tried to increase an employee's leverage to negotiate or refuse to sign noncompetition clauses is by requiring independent consideration where an employee is presented with a noncompetition agreement after commencing employment. Under the common law of most states, no independent consideration beyond the continuation of at-will employment is required to support a noncompetition agreement in such a circumstance. Legislation introduced in Massachusetts and Washington requires separate consideration, independent of continued employment, to support a noncompete signed during the term of employment. A bill in Maine would not require independent consideration, but mandates that the employee must continue to be employed for at least six months after the noncompete's execution in order for the agreement to be enforceable.

Employee Causes of Action: In many noncompete cases, the employer will have considerably greater resources to devote to litigation than the former employee. This disparity can pressure a departing employee to accede to the former employer's demands rather than face the prospect of protracted and expensive litigation. While state restrictions on noncompetition agreements provide a shield to protect employees from liability, many legislative proposals seek to also give employees a sword to fight back against noncompete claims brought by former employers.

As of May 10, 2016, Utah law permits employees to recover their attorney's fees and arbitration costs incurred in any action in which a noncompetition agreement is found to be unenforceable. A measure pending in the Washington Senate provides a former employee with a cause of action to recover damages caused by an attempt to enforce an illegal noncompete, while a companion bill in the Washington House of Representatives requires that the employer have known that the noncompetition agreement was unenforceable in order for the employee to recover. Legislation introduced in Maine and Nevada does not provide employees with a cause of action, but imposes a civil (Maine) or criminal (Nevada) penalty against employers seeking to enforce unenforceable agreements.

Other Types of Restrictive Covenants Distinguished: At least so far, state legislatures have focused their energy on noncompetition agreements, and have not sought to place limits on the enforceability of other types of restrictive covenants like customer-focused nonsolicitation and confidentiality agreements. Some of the bills under consideration expressly disclaim any intention to render these more limited restrictive covenants unenforceable. This differential treatment suggests that when the justification for limiting an employee's competition is the employee's customer contacts and goodwill, as opposed to access to trade secrets, unique skills, or a senior management role, employers may be better off taking the more conservative approach of prohibiting the employee from working with specific customers or groups of customers after termination.

Clearly, there is significant momentum behind the state-level push to regulate the use of noncompetition agreements. These new measures reinforce the need for multistate employers to ensure that their restrictive covenants are tailored so that they will be enforceable in each applicable jurisdiction and are updated to pass muster under the latest statutes and case law. Not doing so risks the loss of confidential information trade secrets and poaching of valuable client relationships, a fate few employers wish to encounter.

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