Restrictive Covenants:

Key Developments and Practical Considerations in Employment Law

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Presenters

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Agenda

- Review of Recent Changes in Restrictive Covenant Laws
- Trends, Including Increased Restrictions on Restrictive Covenants for Low Wage & Other Workers (*e.g.*, Choice of Law and Low Wage Restrictions, and Garden Leave)
- Other Changes on the Horizon (*e.g.*, President Biden's Executive Order)

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Restrictive Covenant Reform Efforts

Illinois

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Amendments to the Illinois Freedom to Work Act

- Illinois legislature passed Senate Bill 672 on May 31, 2021.
- Signed into law by Governor J.B. Pritzker on August 13, 2021.
- Applies to restrictive covenant agreements executed after January 1, 2022.
- Introduces new restrictions on both non-compete agreements and customer/employee non-solicitation agreements.

Non-Compete Earning Thresholds

- **Non-Compete Agreements**
  - Prohibits non-competes for employees with earnings **less than $75,000/year.**
    - **Earnings**: Salary, bonuses, commissions, or other forms of taxable compensation.
    - This threshold increases every five years.
    - "Earnings" include salary, bonuses, commissions or other form of taxable compensation.

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Non-Compete Earning Thresholds

- Specific exclusions from the definition of “non-compete.”
  - Covenants not to solicit (which are covered separately in the legislation);
  - Confidentiality agreements or covenants;
  - Covenants or agreements prohibiting the use or disclosure of trade secrets or inventions;
  - Invention assignment agreements or covenants;
  - Covenants or agreements entered into by a person purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest;
  - Clauses or agreements between an employer and an employee requiring advance notice of termination of employment, during which notice period the employee remains employed by the employer and receives compensation; or
  - Agreements by which the employee agrees not to reapply for employment to the same employer after termination.

Non-Solicitation Earning Thresholds

- **Non-Solicitation Agreements**
  - Prohibits non-solicits for employees with earnings **less than $45,000/year.**
    - Threshold increases every five years.
  - Applies to both customer and employee non-solicits.
    - A “covenant not to solicit” is defined as an agreement that prohibits an employee from trying to hire the employer’s employees or which restricts the employee from soliciting the employer’s clients, prospective clients, vendors, prospective vendors, suppliers, prospective suppliers, or other business relationships.

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Drafting an Enforceable Agreement

- Enforcement Elements:
  - Restrictive covenants are **illegal and void** unless:
    - the employee receives adequate consideration;
    - the covenant is ancillary to a valid employment relationship;
    - the covenant is no greater than required to protect the employer's legitimate business interest;
    - the covenant does not impose undue hardship on the employee; and
    - the covenant is not injurious to the public.

Drafting an Enforceable Agreement

- Consideration Definition:
  - **Adequate Consideration** is defined to mean:
    - The employee worked for the employer for at least two years after the employee signed an agreement containing a non-compete or non-solicit; or
    - The employer otherwise provided consideration adequate to support a non-compete or non-solicit.
      - Note that the bill does not define what type or amount of "professional or financial benefits" would be adequate.
  - Codifies *Fifield v. Premier Dealer Services, Inc*., 2013 IL App (1st) 120327 (2013).

Additional Limitations

- Judicial Reformation
  - "Extensive judicial reformation . . . may be against the public policy . . . and a court may [exercise its discretion to reform, sever, or] refrain from wholly rewriting contracts."
  - Factors which may be considered 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.

- Collective Bargaining/Construction Employees
  - Non-competes are **void and illegal** with respect to:
    - Individuals covered by a collective bargaining agreement; and
    - Individuals employed in construction, except those who primarily perform certain functions

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Additional Limitations, Cont.

- Notice Requirements
  - **Advance written notice** must:
    - advise the employee to consult with an attorney before entering into the covenant, and
    - include a copy of the covenant at least 14 calendar days before the commencement of the employee's employment or provide the employee with at least 14 calendar days to review the covenant.
      - An employer is in compliance with this provision even if the employee voluntarily elects to sign the covenant before the expiration of the 14-day period.

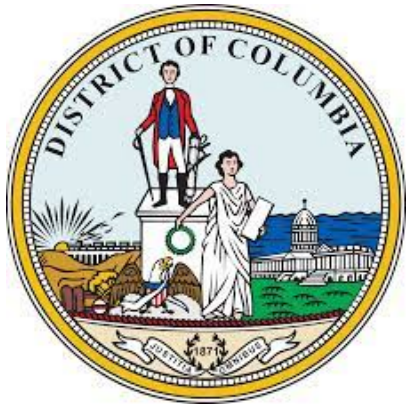
- Attorneys' Fees
  - An **employee can recover attorneys' fees** if he or she "prevails" in litigation.
  - Whether "prevail" means total, or just partial, success is still not clear.

Restrictive Covenant Reform Efforts

Washington, D.C.

D.C.’s Ban on Non-Compete Agreements Amendment Act

- The Council of the District of Columbia passed the Ban on Non-Compete Agreements Amendment Act of 2020 on December 17, 2020.
- Goes into full effect on April 1, 2022.
- Is the broadest ban on non-competes in the country
  - Subject to narrow exceptions, renders void and unenforceable non-competes executed after April 1, 2022.
  - **Also bars restrictions on simultaneous employment**



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The Act's Prohibitions – Non-Compete Agreement Ban

- Employers operating in D.C. may not require or request an employee sign an agreement that includes a non-compete provision.
- Applies to almost all employees who perform (or are reasonably anticipated to perform) work in D.C.
- Applies only to agreements executed on or after April 1, 2022
- "**Non-compete provision**" is defined as a provision of a written agreement that prohibits the employee from being simultaneously or subsequently:
  (1) employed by another person;
  (2) performing work or providing services for pay for another person; or
  (3) operating the employee's own business.

Exceptions to Non-Compete Agreement Ban

- Non-disclosure/confidentiality agreements
  - *Silent on non-solicitation agreements*
- Agreements executed in connection with sale of a business.
- Volunteers
- “Casual babysitters”
- “Lay member[s] elected or appointed to office within the discipline of any religious organization and engaged in religious functions”
- Medical specialists (i.e., licensed physicians) earning over $250,000.

The Act's Prohibitions – Workplace policies and Anti-Retaliation

- Employers operating in D.C. may not:
  - Have workplace policies that prohibit an employee from:
    (1) Being employed by another person;
    (2) Performing work or providing paid services for another person; or
    (3) Operating the employee's own business.
  - Retaliate (or threaten to retaliate) against employees for:
    - Refusing to enter into a non-compete agreement
    - Failing to comply with a covered non-competition provision or workplace policy made unlawful by the Act
    - Asking, informing or complaining about the existence, applicability or validity of a non-compete provision or workplace policy the employee reasonably believes is prohibited by the Act
    - Requesting notice of the Act

Notice Requirements

- Employers must provide the following notice to employees, in writing:

"No employer operating in the District of Columbia may request or require any employee working in the District of Columbia to agree to a non-compete policy or agreement, in accordance with the Ban on Non-Compete Agreements Amendment Act of 2020."

- Notice must be provided:
  - 90 calendar days after the applicability date of the Act (April 1, 2022);
  - 7 calendar days after the individual becomes employed; and
  - 14 calendar days after a written request.

Enforcement and Penalties

- Private right of action & administrative complaint procedure.
- Statutory remedies available for violations.
- Administered/enforced by the Mayor & the Attorney General.
- Mayor is empowered to assess administrative remedies.

Stay tuned….

- Indications the Act may be amended before April 1, 2022
  - Proposed amendments would permit “bona fide conflict of interest policies”
    - Such a policy is defined as one that “bars an employee from accepting money or a thing of value from a person during the employee’s employment with the employer because the employer reasonably believes the employee’s acceptance of money or a thing of value from the person will cause the employer to: (A) Conduct its business in an unethical manner; or (B) Violate applicable local, state or federal laws or rules.”
  - Other potential amendments:
    - Permit prohibition on simultaneous employment for employees with access to employer’s confidential information
    - Permit post-employment non-compete for employees with access to employer’s confidential information for up to six months if employee earned more than $80,000 and is paid their salary for the non-compete period.
    - Special industry carve outs: universities, broadcast journalists, sports scouts


Trends
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Out of State Choice of Law

Out of State Choice of Law – California

- California Business and Professions Code § 16600 provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void."
  - Employer Workarounds – Choice of Law/Forum Selection Provisions
- California Labor Code § 925 – Prohibition on choice of law and forum selection provisions

Out of State Choice of Law – California

- § 925 prohibits an employer from requiring, as a condition of employment, an employee to agree to a provision that would either:
  - (1) Require the employee to adjudicate outside of California a claim that arose in California; or
  - (2) Deprive the employee of the substantive protection of California law with respect to a controversy that arose in California.
- Provisions that violate the law are voidable by the employee
  - Where a provision is rendered void by the employee, the matter must then be adjudicated in California and California law will apply.
- Exception to § 925: Where an employee is individually represented by legal counsel in negotiating the terms of an agreement regarding forum selection or choice of law, § 925's prohibitions will not apply.

Out of State Choice of Law – Massachusetts and Washington

- Massachusetts
  - No choice of law provision that would have the effect of avoiding the requirements of this section will be enforceable if the employee is, and has been for at least 30 days immediately preceding his or her cessation of employment, a resident of or employed in Massachusetts at the time of his or her termination of employment.

- Washington
  - A provision in a noncompetition covenant signed by an employee or independent contractor who is Washington-based is void and unenforceable:
    - (1) If the covenant requires the employee or independent contractor to adjudicate a noncompetition covenant outside of this state; and
    - (2) To the extent it deprives the employee or independent contractor of the protections or benefits of this chapter.

Out of State Choice of Law

- *Atl. Marine Constr. Co. v. United States Dist. Court*, 571 U.S. 49 (2013)
  - "[W]hen a plaintiff agrees by contract to bring suit only in a specified forum—presumably in exchange for other binding promises by the defendant—the plaintiff has effectively exercised its 'venue privilege' before a dispute arises."
  - "When parties agree to a forum-selection clause, they waive the right to challenge the preselected forum as inconvenient or less convenient for themselves or their witnesses, or for their pursuit of the litigation. . . a district court may consider arguments about public-interest factors only."
  - "[W]hen a party bound by a forum-selection clause flouts its contractual obligation and files suit in a different forum, a . . . transfer of venue will not carry with it the original venue's choice-of-law rules—a factor that in some circumstances may affect public-interest considerations."

Restrictions on Restrictive Covenants for Low Wage & Other Workers

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State-by-State Restrictions

- A number of states have imposed restrictions on employers' use of restrictive covenants for certain categories of workers, which may include some or all of the following:
  - Workers who make below a certain wage threshold;
  - Non-exempt workers;
  - Workers below the age of 18; and
  - Interns/students.

- The following states have imposed such restrictions, though the specific restrictions imposed vary from state-to-state
  - Illinois;
  - Maine;
  - Maryland;
  - Massachusetts;
  - New Hampshire;
  - Oregon;
  - Rhode Island;
  - Virginia; and
  - Washington.

- A number of other states have pending legislation which, if passed, would impose such restrictions.

State-by-State Restrictions

Maine: Prohibition on non-competes for employees earning wages at or below 400% of the federal poverty level (2021: $51,520).

Maryland: Prohibition on non-competes for employees who earn equal to or less than: (i) $15 per hour; or (ii) $31,200 per year.

Massachusetts: Prohibition on non-competes for: (i) non-exempt employees; (ii) students; (iii) employees that have been terminated without cause or laid off; and (iv) employees under the age of 18.

Oregon: Effective 1/1/2022, non-competes with employees will be void unless, among other things: (i) the exempt employee's annual salary at the time of termination exceeds $100,533; and (ii) the agreement is limited to a one-year duration.

State-by-State Restrictions

New Hampshire: For agreements executed on 9/8/19 or later, prohibition on: non-competes with low-wage employees. Low-wage employees are those who earn an hourly wage less than or equal to 200 percent of federal minimum wage ($14.50 or less per hour or $30,160 annually) or less than or equal to 200 percent of tipped minimum wage in state.

Virginia: Effective July 1, 2020, employers are prohibited from entering into non-competes with low-wage employees. Low-wage employees are those who earn less than Virginia's average weekly wage (about $1,200 per week or $62,000 per year).

Washington: Prohibition on: (i) non-competes for employees who earn less than $100,000 per year (adjusted for inflation); and (ii) non-competes for independent contractors who earn less than $250,000 (adjusted for inflation).

New York Attorney General

- Low Wage Non-Competes - New York Attorney General
  - September 2018: Settlement with coworking space provider regarding its use of non-compete agreements.
  - 2017: Assembly Bill 7864 – prohibiting non-compete agreements with low wage workers.
  - August 2016: Settlement with drug screening company.
  - June 2016: Settlement with fast food sandwich chain.

- Legislative Horizon
  - New York is currently considering several bills aimed at regulating non-compete agreements
  - Trade Secrets Committee of the New York City Bar has called on the state to enact a statute regulating non-competes entered into with low-wage employees.

Garden Leave and Paid Restrictive Periods

- Garden Leave:
  - Continuation of some/all compensation and benefits, without working.

- Massachusetts - Massachusetts Noncompetition Agreement Act
  - Non-compete requires garden leave or other mutually-agreed upon consideration.
  - To constitute a garden leave, the provision must:
    - provide for the payment, on a pro-rata basis, during the entirety of the restricted period of at least 50% of the employee's highest annualized base salary paid by the employer within the 2 years preceding the termination; and
    - except in the event of a breach by the employee, must not permit the employer to unilaterally discontinue or otherwise fail or refuse to make the payments.

Garden Leave and Paid Restrictive Periods, Cont.

- Nevada - Nevada Unfair Trade Practice Act
  - Non-compete prohibited for hourly workers.
  - Garden leave required for employees subject to layoffs.

- Oregon
  - Where an employee is either non-exempt and/or not earning more than $100,533 in annual salary, an employer may impose a non-compete where the employer **agrees in writing** to pay, for a period of 12 months, the greater of:
    - compensation equal to at least 50% of the employee's annual gross base salary; or
    - fifty percent of the $100,553 figure adjusted for inflation each year.

- Washington
  - Employees who are laid off, non-compete agreements will be deemed void and unenforceable unless the employer pays the employee his/her base salary for the restricted period.
  - An employer may offset any compensation the laid off employee earns through subsequent employment during the period of enforcement.

Federal Changes on the Horizon for the Restrictive Covenant Landscape

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Federal Changes on the Horizon?

- President Biden's Executive Order on Promoting Competition in the American Economy
  - President Joe Biden **signed an executive order on July 9, 2021**, which *encourages* the FTC to limit the "unfair use" of non-competes.
- Potential for Increased FTC Actions
  - On April 13, 2020, the Department of Justice's Antitrust Division and the FTC's Bureau of Competition released a joint statement and press release regarding "competition in labor markets" and **potential agency actions in the face of the COVID-19 crisis**.
- Workforce Mobility Act
  - **Proposed federal law** that would severely limit the ability of employers to enter into non-compete agreements with their employees.

Federal Action On No-Poaching Agreements

- *U.S. v. Surgical Care Affiliates, LLC et al.* (N.D. Tex. 2021)
  - On January 5, 2021, a federal grand jury in the Northern District of Texas returned a two-count indictment against Defendants charging them with violations of Section 1 of the Sherman Act for entering into no-poach agreements with competitors.
- The DOJ previously warned that it would consider bringing a criminal no-poach action in guidance jointly released with the Federal Trade Commission.
- New York Attorney General reached an agreement on Sept. 9, 2021 with a national title insurance company requiring it to cease from entering into agreements with independent insurance agencies not to hire each others' employees.
  - "My office will continue to investigate no-poach agreements that potentially harm New York workers, and fight to end these anticompetitive practices once and for all." – NYAG Letitia James

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