CLIENT ALERT: The Proliferation of State Noncompetition Agreement Laws and the Potential Federal Response

Recently, there has been a growing movement to limit the use of noncompetition agreements across the United States. With various states taking different legal positions regarding the enforceability of these restrictive covenants, it is becoming more and more difficult for multi-state employers to be able to maintain enforceable agreements without careful planning and analysis.

For instance, in 2020, the State of Washington barred noncompetition agreements for anyone earning less than approximately $100,000 annually, joining the list of states, including Massachusetts and Rhode Island, which have put limitations on who may be bound by a noncompetition agreement. This trend has extended to the District of Columbia, where there is a bill pending to abolish noncompetition agreements completely. During his campaign, President Biden announced a policy position seeking to abolish noncompetition agreements. With many states considering these issues, employers must be mindful of the various state laws which may impact whether they can restrict a former employee from competing after the employee's employment ends.

Restrictive Covenants Generally

A restrictive covenant is a contractual clause or agreement that prohibits an individual from engaging in certain conduct after his or her employment ends. The most common restrictive covenants are noncompetition agreements, nonsolicitation agreements, and nondisclosure agreements. A noncompetition agreement typically restricts an employee from competing with his or her employer in a particular manner for a certain period of time within a certain geographic territory. A nonsolicitation agreement generally prohibits employees from soliciting – for their own benefit or the benefit of another employer – their former employer's employees and/or clients for a certain period of time. A nondisclosure agreement requires that employees maintain their employer's proprietary information and trade secrets in confidence and not otherwise use that information for their own benefit or the benefit of another employer – at any point following their employment or for a limited period of time. One single document may contain more than one type of these contractual clauses.

Noncompetition, nonsolicitation, and nondisclosure agreements each seek, conceptually, to protect an employer's legitimate business interests, including its confidential information, trade secrets, and goodwill. This includes the protection against an employee leaving to join a competitor and unfairly trade upon the former employer's interests for the benefit of the employee and/or the competitor. Still, when considering whether and how to enforce these agreements, courts wrestle with the tension between (1) the protection of these business interests, (2) the restraint on employee mobility and ability to earn more money, and (3) ordinary and appropriate competition to which all businesses are subject.

In today's mobile society, it is not always readily apparent which state law applies when reviewing an agreement. Although it is logical to apply the state law of either where the employee works or where the employer is headquartered, most contracts also contain a "choice of law" provision which sets out the parties' agreement as to which state law to apply. However, even if a contract has a provision that provides for the application of a particular state's law, a court may not enforce that provision. In many jurisdictions, courts will analyze the question under a complicated "choice of law" doctrine that exists in every state. Further complicating the analysis, some states, including Massachusetts, require application of state law by statute. In short, although careful analysis in contract drafting can address some of the risks of state law choice, one can only be sure of which law will apply to an agreement after the issue is reviewed and settled through court proceedings.

State Approach to Restrictive Covenants

Of the restrictive covenants, noncompetition agreements are considered to have the greatest impact on employee mobility and ordinary competition, and therefore are often the focus of states' restrictive covenant laws. States take differing approaches to noncompetition agreements, and the recent state law trend is to limit the use of such clauses in various circumstances.

Each states' approach varies, but one of the most common approaches is to limit the use of noncompetition agreements for certain lower-wage workers. For example, Illinois, Maine, Massachusetts, New Hampshire, Rhode Island, Virginia, Maryland, Oregon, and Washington have limited the use of restrictive covenants against low-wage workers (or in the case of Massachusetts, against non-exempt employees). These laws also may limit the duration and scope of permitted restrictions, and establish procedural notice requirements for those who are asked to sign a restrictive covenant. The State of Washington goes even further, imposing financial penalties on employers who seek to over-use restrictive covenants in violation of the statute. Some states also ban restrictive covenants for specific professions and industries such as broadcasting and physicians engaged in the practice of medicine.

Some states, including California, and North Dakota, completely prohibit certain restrictive covenants between employers and employees, permitting such clauses only in the context of a sale of a business. Oklahoma prohibits noncompetition agreements between employees and their employer but allows nonsolicitation agreements.

The District of Columbia is poised to join the states banishing certain restrictive covenants in employment. On December 15, 2020, the D.C. Council unanimously passed Bill 23-494 to ban the use of noncompete provisions in employment agreements and workplace policies, and on January 11. 2021, Mayor Muriel Bowser signed the bill, which awaits final approval in Congress. The D.C. law, if approved, would:

- prohibit employers from requiring or requesting employees to sign any agreement containing a noncompetition provision;
- prohibit employers from implementing a workplace policy that prohibits being (1) employed by another person, (2) performing work or services for pay for another person, or (3) operating their own business;
- prohibit employers from retaliating or threatening to retaliate against an employee for refusing to agree to a noncompetition provision or failure to comply with the employer's noncompetition provision or policy; and
- impose penalties for any violation of the law.

Ultimately, states take a wide range of approaches to noncompetition agreements, and state laws further address the use and enforceability of these clauses beyond what is mentioned above. Where noncompetition agreements may not be enforceable –because of circumstance and/or state law – employers are largely left to rely upon nondisclosure agreements and nonsolicitation agreements (to the extent they are not also restricted by state law) to try and protect their legitimate business interests. In short, the days of employers being able to maintain a noncompetition agreement that would be enforceable in the same manner in most of the United States are over.

President Biden's Anticipated Agenda Includes Limitations on Noncompetition Agreements

On top of the foregoing state-by-state concerns, it is possible that the Federal government may soon enter the fray and consider laws that affect noncompetition agreements across the country. President Biden's arrival in Washington D.C. and policy agenda signal that there could soon be Federal action taken to address, eliminate or diminish the scope of noncompetition agreements, as well as other restrictive covenants, in the future. Indeed, President Biden has expressed his disfavor

of noncompetition agreements in The Biden Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions. The plan explains that President Biden intends to "work with Congress to eliminate all noncompetition agreements, except the very few that are absolutely necessary to protect a narrowly defined category of trade secrets, and outright ban all no-poaching agreements." It is too early to know the approach that President Biden's administration will take when seeking to implement this policy goal, including the breadth of any restrictions it may seek or whether any related legislation will actually pass.

MBJ will continue to monitor these important developments. Employers are encouraged to work with their MBJ attorney to strategize on the best way to increase protections for their confidential information, trade secrets, and goodwill, including which restrictive covenants may be best suited for their workforce.

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