Non-Compete Updates
Where Are We? What to Expect.

ACC Association of Corporate Counsel
NATIONAL CAPITAL REGION

SheppardMullin

What We'll Cover Today

- Local Laws: DC, Maryland, and Virginia.
- The Legal Landscape Across the Country
- The Biden Administration's Push on Non-Competes
- Best Practices – a Tiered Approach
- What to Expect Moving Forward

Local: Washington, DC

- New law goes into effect October 1, 2022.
- How far we've come!
  - Original law would have been most restrictive in the country
  - Would have applied to all employers who had any employee who worked in DC for any amount of time
  - Employees could have worked at Coke and Pepsi *at the same time*
- The Non-Compete Clarification Amendment Act of 2022
  - Passed in August 2022
  - The result of a *lot* of pushback from the business community
  - Significantly narrows the scope of the original law

The Non-Compete Clarification Amendment Act

- Applies to: employees who will spend substantial time working in D.C. but not more than 50% of their time working in another jurisdiction.
- Does NOT apply to: “highly compensated employees” who earn $150,000 or more annually. This $150,000 includes bonuses, commissions, overtime pay, and vested stocks.
- Like before, medical specialists are excluded (with $250,000 salary threshold) and now, also broadcast employees are also excluded.

The Non-Compete Clarification Amendment Act

- “Moonlighting” is now prohibited *if* such work would result in the employer’s sensitive or proprietary information being disclosed or present a conflict of interest
- Employers may bar an employee's use and disclosure of confidential and proprietary information (trade secrets) *during and after* the employee's employment for the employer.
- Employees who believe their agreements violate the law, may bring a complaint to the Mayor’s office or civil suit. D.C. Administrative fines range from $350 to $1,000 per violation, and the employer can be directly liable to an affected employee in the amount of $500 to $1,000 for a first offense, and not less than $3,000 for a subsequent offense.

Local: Virginia

- Virginia has a complete ban on non-competes for low-wage earners.
- A low-wage earner as defined by the law, in 2022, has a salary of approximately $67,080 annually.
- Importantly, the law does *not* ban the use of confidentiality or non-disclosure agreements.

Local: Maryland

- The Maryland Non-Compete and Conflict of Interest Clauses Act prohibits using non-compete clauses for employees who earn $15 per hour or less or $31,200 annually.
- For covered employees, employers may not restrict their ability to work a second job or “moonlight” in the same industry.
- But, the law does *not* restrict employers and employees from entering into agreements prohibiting the taking of client lists or other proprietary information.

Patchwork of State Laws

- As you can see from just the local DC area, non-compete laws vary drastically. The same can be said for non-compete laws across the country.
- There are states where non-competes are outright prohibited and others where they are strictly regulated by statute.

Patchwork of State Laws

- Non-competes are generally prohibited in the following states:
  - California
  - Oklahoma
  - North Dakota

Patchwork of State Laws

- Other states have strict requirements for restrictive covenants, such as salary thresholds, garden leave provisions, consideration, and/or restrictions on choice of law provisions.
- These states include (among others):
  - Massachusetts
  - Washington
  - Colorado
  - Illinois
  - Oregon
  - Nevada
  - Washington, D.C.

By way of example…

- Colorado recently amended its non-compete statute.
  - Non-compete covenants are only enforceable against “highly compensated workers.” - $101,250
  - Non-solicitation covenants are only enforceable against workers who earn 60% of the “highly compensated” threshold.
  - Employers must give “pre-offer” notice restrictive covenants to new employees. Current workers must receive 14 days’ notice of any new restrictions.
  - Employees must sign and acknowledge they received notice in a separate document.
- There are harsh penalties for non-compliance.

By way of example…

- Illinois also amended its non-compete law in early 2022.
  - Applies to both non-competes and non-solicitation provisions.
  - Non-competes may only be enforced against those who earn more than $75,000 annually.
  - Non-solicitation agreements may only be enforced against employees who earn more than $45,000 annually.
  - Continued employment is not sufficient consideration. Employers must provide some other financial or other benefit to the employee.
  - Employees may recover their attorneys' fees and costs from employers in unsuccessful enforcement actions. There is no reciprocal provision for employees.
  - Employers must advise employees in writing to consult with an attorney prior to signing and allow employees 14-days to review the agreement.

Consider Consideration

- In many (or most) states, initial employment constitutes adequate consideration to support a restrictive covenant entered into at the inception of an employment relationship.
  - Unless you are in Illinois, Missouri, or Texas.
- However, many states require additional consideration for restrictive covenants entered into midstream of employment, or after the employment relationship has already commenced.
  - This may be a signing bonus, a raise, a change in job duties, a title change, stock options, or any other “benefit” to the employee.

States Where Additional Consideration Is Required Midstream of Employment

- Massachusetts
- Montana
- North Carolina
- South Carolina
- Oregon
- Pennsylvania
- Texas
- Washington
- West Virginia
- Wyoming
  - **This issue is either undecided or simply unclear in many other states.

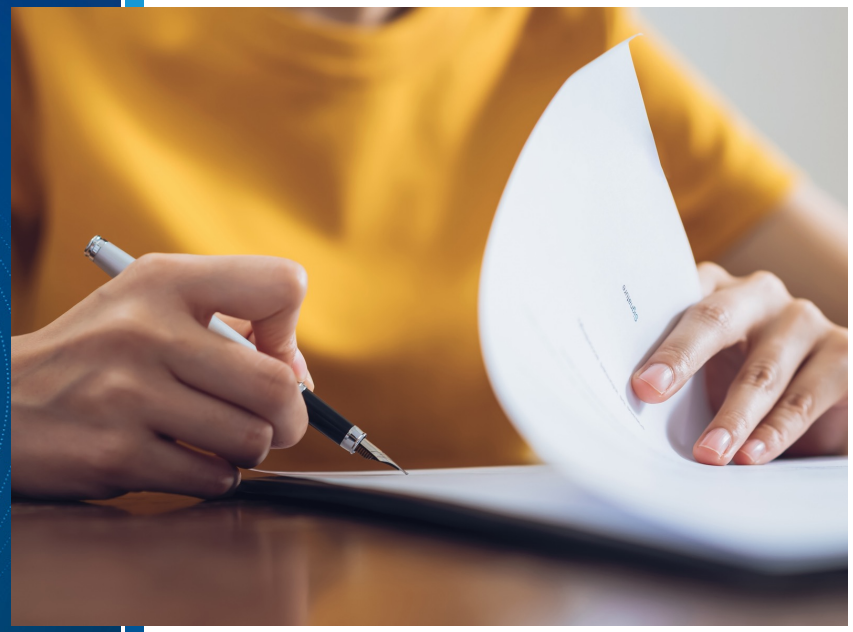
What's to Come: State Laws

- Restrictive non-compete legislation is pending in New Jersey, Connecticut, and New York.

What's to Come: The Biden Administration's Focus

- Non-Competes have always been a focus for President Biden – long before he was elected.
- Just over a year ago, in July 2021, President Biden, issued an Executive Order directing the Federal Trade Commission ("FTC") "to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."
- We awaited rulemaking or any other guidance from the FTC on how this work…now we know.

What's to Come: The Biden Administration's Focus



- This summer, the FTC's enhanced scrutiny of non-competes was on full display when they filed a complaint against a company for their use of non-compete provisions in their transaction.
- When releasing the Complaint, the FTC Chair stated: "The Commission will evaluate agreements not to compete in merger agreements *with a critical eye*."

What's to Come: The Biden Administration's Focus

- The "default" non-compete and non-solicitation provisions in merger agreements will continue to face heightened scrutiny.
- "No Poach" *indictments* have been filed – the DOJ is also targeting agreements between competitors to not poach each other's workers

Non-Solicitation. The Parties agree that during the Term of this Agreement and for twelve (12) months following termination of this Agreement for any reason (the "Restricted Period"), neither Party shall, directly or indirectly, solicit, induce or recruit or otherwise retain ~~any of the current employee~~ any employee at the director-level or above of the other Party. The Parties agree that the interview or hire of the other Party's employee as a result of an advertisement or job posting directed to the general public, or the hire of the other Party's employee resulting from the receipt of an unsolicited resume, will not violate the Agreement.

What's to Come: The Biden Administration's Focus

- President Biden will continue his focus on non-competes…he is *not* a fan.
- Other than the FTC, expect a continued push on states to ban non-competes for low-wage earners.
- Afterall, the Executive Order encourages a ban and/or limit to

non-compete agreements "altogether"

Best Practices: A “Tiered” Approach

- Consider a “tiered” approach to restrictive covenant agreements.
- Under this approach, employers assess the appropriate restrictions for specific employees based on their job level, duties and responsibilities, customer relationships, and/or access to confidential information.

A “Tiered” Approach

- Tier 1 – Non-Compete, Non-Solicit (Customer and Employee), Confidentiality/NDA
- Tier 2 – Non-Solicit (Customer and/or Employee) and Confidentiality/NDA
- Tier 3 – Confidentiality/NDA

Best Practices: Narrowly Tailored Language

- As courts become increasingly hostile to restrictive covenant agreements, especially non-compete restrictions, narrowly tailored language is critical.
- Tailored scope of activity restrictions, clear definitions of the “business” and/or “competitors,” and narrowly defined “restricted customers” are important in drafting.

Best Practices: Narrowly Tailored Language

- Scope of activity restrictions are important as many states will strike down overbroad provisions under the "janitor rule."
- For example:
  - Non-Compete. Employee covenants and agrees that, for a period of twelve (12) months following Employee's last day of employment with the Company, Employee shall not: (a) engage in any Competitive Activity (as defined below) within the Prohibited Territory (as defined below); or (b) assist anyone else in engaging in Competitive Activity within the Prohibited Territory.
  - "Competitive Activity" means competing against the Company by doing any of the following in a Prohibited Territory for an entity engaged in the Business (as defined below): (a) performing the same or similar work as Employee performed on behalf of the Company at any time during the last twelve (12) months of employment with the Company; (b) performing work in any executive or upper management capacity; (c) performing work which involves the management or oversight of others who perform duties or services similar to the duties or services Employee performed for the Company during Employee's last twelve (12) months of employment with the Company; and/or (d) performing work in any capacity that would be reasonably likely to risk the disclosure and/or use of Confidential Information. Notwithstanding the preceding, owning the stock or options to acquire stock totaling less than 5% of the outstanding shares in a public company shall not constitute, by itself, Competitive Activity.

Best Practices: Narrowly Tailored Language

- Customer non-solicitation provisions should not apply to any and all company customers, but instead those with whom the employee actually worked and/or about whom the employee had information.
  - "Restricted Customer" means: (a) any customer of the Company with whom Employee had contact or communications at any time during Employee's last twelve (12) months as a Company employee; (b) any customer of the Company for whom Employee supervised the Company's account or dealings at any time during Employee's last twelve (12) months as a Company employee; and/or (c) any customer of the Company about whom Employee obtained any Confidential Information (as defined below) during Employee's last twelve (12) months as a Company employee.

Best Practices: Narrowly Tailored Language

- Temporal and geographical restrictions are also important and often can “make or break” enforceability.
- Avoid restrictions more than 12-18 months outside of exceptional circumstances.
- Consider whether geography may be tailored to something other than “the United States.” For example:
  - “Prohibited Territory” means: (a) each state where Employee assisted the Company to engage in the Business at any time during the last twelve (12) months of Employee’s employment with the Company; and (b) any territory assigned to Employee by the Company at any time during the last twelve (12) months of Employee’s employment with the Company.

Enforcement Considerations: Non-Competes

- Putting emotion aside – what should a company consider?
- Think before you act!
- C Suite vs. Business “boots on the ground”
- Discovery – depositions, documents, dollars…oh my!
- What is the real goal?

Questions?

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