Massachusetts Passes New Law That Restricts Noncompetition Agreements

In August of this year, Massachusetts Gov. Charlie Baker signed into law an omnibus economic development law (the "Law"). Of major significance, the Law contains provisions that fundamentally change the way employee noncompetition agreements are regulated in Massachusetts. While the Law does not abolish noncompetition agreements in Massachusetts, it substantially limits the terms upon which employers can enter into noncompetition agreements with employees and other workers.

The Law became effective on October 1, 2018, and applies to all employee noncompetition agreements, as they relate to Massachusetts employees, executed after that date.

For Massachusetts-based employers, and for companies with employees who work in Massachusetts, it is critical to understand this new Law and its impact.

STRUCTURE AND PROCEDURAL REQUIREMENTS

Under the Law, a noncompetition agreement is invalid unless it is in writing and signed by both the employer and the employee, and expressly states that the employee has the right to consult with an attorney.

• If the noncompetition agreement is presented in connection with the commencement of employment, the agreement must be provided to the employee with the formal offer of employment or 10 business days before the commencement of employment, whichever is earlier;
• If the noncompetition agreement is presented after the commencement of employment, the agreement must be supported by additional consideration independent from the continuation of employment, and notice of the agreement must be provided at least 10 business days before the agreement is to become effective.

In addition, a noncompetition agreement is invalid unless it is supported by either "garden leave" pay or some "other mutually-agreed upon consideration." If an employer elects to support a noncompetition agreement with garden leave pay, the garden leave provision must require the employer to continue to pay the former employee during the restricted period of the noncompetition agreement, with an amount that is "at least 50 percent of the employee's highest annualized base salary paid by the employer within the two years preceding the employee's termination."

However, the Law is silent with respect to the definition and requirements of "other" consideration. As such, it appears that if an employer elects to support a noncompetition agreement with "other consideration," that consideration may be paid at any time (such as a hiring bonus), at a rate that is more or less than the garden leave pay rate set in the Law.

LIMITS ON THE SCOPE OF RESTRICTIONS

Under the Law, the scope of restrictions contained in a noncompetition agreement:

• May not exceed 12 months from the end date of employment (unless a limited exception applies);
• Must be limited to the geographic areas in which the employee, during the last two years of employment, "provided services or had a material presence or influence;"
• Must be limited to the specific type of services the employee provided to the employer during the last two years of employment.

In addition, a noncompetition agreement is invalid unless an employer can demonstrate that no other type of restrictive covenant (e.g., a non-solicitation or non-disclosure agreement) is sufficient to protect the "legitimate

business interests" of the employer. Under the Law, the legitimate business interests of an employer are defined narrowly, and limited to: trade secrets, confidential business information and goodwill.

BAN WITH RESPECT TO CERTAIN TYPES OF EMPLOYEES

Under the Law, noncompetition agreements are invalid and not enforceable against the following categories of employees:

- Employees who have been terminated without cause or laid off;
- Employees who are classified as non-exempt under the Fair Labor Standards Act;
- Undergraduate or graduate students who are engaged in short-term employment;
- Employees who are 18 years of age or younger.

RESTRICTIVE COVENANTS THAT ARE NOT REGULATED BY THE LEGISLATION

The above-limitations apply only to so-called "noncompetition agreements," which are defined as agreements "between an employer and an employee, . . . arising out of an existing or anticipated employment relationship, under which the employee or expected employee agrees that he or she will not engage in certain specified activities competitive with his or her employer after the employment relationship has ended." For purposes of this definition, the term "employee" includes any person "providing service" to an employer, including independent contractors.

The Law does not apply to certain other types of restrictive covenants, identified as the following:

- covenants not to solicit or hire employees of the employer;
- covenants not to solicit or transact business with customers, clients, or vendors of the employer;
- noncompetition agreements made in connection with the sale of a business if the party restricted by the noncompetition agreement is a "significant owner" of the seller, and receives "significant consideration" as a result of the sale;
- noncompetition agreements outside of an employment relationship;
- forfeiture agreements (an agreement that imposes adverse financial consequences on a former employee as a result of the termination of an employment relationship, regardless of whether the employee engages in competitive activities following cessation of the employment relationship);
- nondisclosure or confidentiality agreements;
- invention assignment agreements;
- noncompetition agreements made in connection with the cessation of or separation from employment, if the employee is expressly given seven business days to rescind acceptance; or
- agreements by which an employee agrees to not reapply for employment to the same employer after termination of the employee.

Such agreements, by express provision, are not regulated by the new Law, and remain governed by common law standards.

LIMITS ON "CONTRACTING AROUND" THE LAW

Employers cannot avoid the Law limitation on noncompetition agreements by selecting another state's law in their noncompetition agreements. Under the Law, a choice of law provision applying the law of any state other than Massachusetts will not be enforceable if the employee has been a resident of, or employed in, Massachusetts for at least 30 days immediately prior to termination of employment. In addition, employers seeking to enforce noncompetition agreements must bring any enforcement action in the county where the employee lives, or if agreed to by the employer and employee, in Suffolk County's superior court or its business litigation session.

IMPACT ON EMPLOYER STRATEGY

The restrictions on noncompetition agreements provided in the Law represent a double-edged sword: The Law provides employers with an opportunity to hire certain employees and independent contractors who were previously “off-limits” due to a restrictive covenant. At the same time, employers are prevented from enforcing certain types of valuable restrictions against their current workforce. The Law may cause some employers to reconsider the use noncompetition agreements altogether, while other employers may be incentivized to modify their use of restrictive covenants to comply with the Law.

In the end, the Law requires employers to evaluate their past use of noncompetition agreements, identify the reasons why they relied on noncompetition agreements to protect their business interests, and to work with their trusted legal advisors to develop strategies to achieve their business interests within the confines and restrictions of the Law.

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