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Noncompete Agreements: What's New and What's on the Horizon?

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As we reported in October 2023, noncompete agreements continue to receive widespread scrutiny – a trend that has continued in the first quarter of 2024. In this update, we describe what you need to know about the latest developments restricting the use of these agreements.

Washington expands noncompetition restrictions

Washington employers with noncompetition agreements with employees or independent contractors may need to modify those agreements to comply with the latest amendment, SB 5935, to the state's noncompetition laws, **effective June 6, 2024**. Since 2020, Washington has had a broad law that, among other things, imposes numerous restrictions on noncompetes, including:

- A minimum compensation threshold for entering into a noncompete (for 2024, $120,559.99 for employees and $301,399.98 for independent contractors).
- An 18-month noncompete duration limit.
- A requirement that employers pay the employee the equivalent to their base salary at the time of termination, for the period of enforcement, if they are seeking to enforce noncompete agreements against employees terminated as a result of a "layoff," a term undefined under the law.

There also is a requirement that, during employment, employers may not restrict, restrain or prohibit an employee earning less than twice the applicable state minimum hourly wage from having an additional job, supplementing their income by working for another employer, working as an independent contractor or being self-employed.

The latest amendment strengthens the already robust restrictions, as outlined below.

Liberal construction

At the outset, the amendment inserts language stressing that provisions of the law and the amendment "facilitating workforce mobility and protecting employees and independent contractors need to be liberally construed and exceptions narrowly construed." Presumably, then, courts will be expected to interpret the amendment in a manner that serves to provide limited exceptions and covers a broad scope of agreements, as detailed below.

Broadened definition of noncompetes

The amendment expands on the law's existing definition of a noncompete, which presently includes "every written or oral covenant, agreement, or contract by which an employee or independent contractor is prohibited or restrained from engaging in a lawful profession, trade, or business of any kind." Effective June 6, 2024, the definition of a "noncompetition covenant" will also include "[any] agreement that directly or indirectly prohibits the acceptance or transaction of business with a customer."

Customer nonsolicitation exception limited to current customers

Customer nonsolicitation agreements excepted from the law's requirements may only apply to **current** customers. Employee nonsolicitation agreements are still excepted from the law's scope.

Sale of business exception narrowed

Previously, the law excluded from the definition of a noncompete those agreements "entered into by a person purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest." The amendment narrows this "sale of business" exception to situations in which the person signing the covenant "purchases, sells, acquires, or disposes of an interest representing [1%] or more of the business." Other critical exceptions to the law – including exceptions for confidentiality agreements and covenants prohibiting the use or disclosure of trade secrets or inventions – remain unchanged. However, as described above, these exceptions will now be narrowly construed.

Notice and consideration

Previously, employers were required to present a noncompete to a prospective employee by no later than the time the employee accepted an offer of employment. Under the amendment, employers must now ensure employees have notice of the noncompete "no later than the time of the **initial oral or written** acceptance of the offer" (emphasis added). The amendment does not change the law's existing requirement that employers must disclose noncompete agreements to employees who are not currently subject to them but who may be in the future upon meeting the minimum compensation threshold. Employers are still required to provide current employees additional consideration in exchange for a noncompete, independent from continued employment, such as a pay raise or bonus.

Choice of law

The amendment provides that a noncompete is void and unenforceable if it allows or requires the application of choice of law principles or the substantive law of any jurisdiction other than Washington. Previously, employers were only prohibited from requiring disputes to be adjudicated outside of Washington.

Lawsuits

The amendment expands standing to sue under the law, such that any person aggrieved by a prohibited noncompete covenant – regardless of whether the aggrieved person is a party to the noncompete – may recover damages and seek remedies available under the law. This expansion could be interpreted to include future employers of a former employee. Further, the amendment clarifies that a cause of action may not be brought for a noncompete signed prior to January 1, 2020 (the effective date of the law), unless the noncompete is "being enforced **or explicitly leveraged**" (emphasis added).

What's on the horizon in 2024?

FTC's proposed rule

The Federal Trade Commission (FTC) leads the pack on the most sweeping proposal to date, by categorically seeking to ban all noncompete agreements. This proposed rule (**described in this January 2023 alert**) is expected to be finalized in April 2024. If

finalized, the rule would become effective 60 days thereafter, though employers will have 180 days after publication of the final rule to comply. Should the FTC adopt the proposed rule or even a narrower version of it that still includes a broad noncompete ban, the rule will be subject to significant legal challenges – including that the FTC lacks authority to engage in this type of rulemaking as asserted by former FTC Commissioner Christine Wilson.

Maine

Following **Minnesota's lead**, which banned all noncompetes last year, Maine attempted to become the next state to prohibit noncompetes. **HP 951** proposed to amend the current noncompete law in Maine (which prohibits such agreements for employees earning at or less than 400% of the federal poverty level), to ban their use completely, subject to certain sale of business exceptions. Although the bill passed both the House and Senate on March 19, 2024, it was recently vetoed by Gov. Janet Mills, who expressed that a complete ban was not appropriate and would ignore "the fact that noncompete agreements can be critical tools to prevent employees from taking unfair advantage of their former employers."

New York

As **we reported in October 2023**, New York proposed its own noncompete ban via Senate Bill S3100A, which would have prohibited employers from seeking or requiring anyone who is in a "position of economic dependence on, and under an obligation to perform duties for," employers, from entering into a noncompete agreement, with limited exceptions. Unlike other state noncompete laws, New York's proposal did not include a salary threshold or address the permissibility of certain sale of business exceptions to the law. In a nod to some of these deficiencies, as echoed by Mills, Gov. Kathy Hochul vetoed the bill on December 22, 2023, stating that while she long supported limits on noncompete agreements for middle- and low-wage workers, the proposal constituted a "one-size-fits-all approach" that did not account for "allowing New York's businesses to retain highly compensated talent" in which companies "have legitimate interests" that are protected through noncompetes.

While no new measure has been introduced to date at the state level, the New York City Council has remained active in this space, having introduced three new bills aimed at limiting the use of noncompete agreements:

- **Bill Int. No. 140** – This bill would categorically ban all noncompetes, with such agreements broadly defined as "an agreement between an employer and a worker that prevents, or effectively prevents, the worker from seeking or accepting work for a different employer, or from operating a business, after the worker no longer works for the employer." The proposal generally extends such prohibitions to cover anyone who does work "whether paid or unpaid" for an employer, including individuals classified as independent contractors. The proposal also requires employers to rescind any existing noncompetes and prohibits employers from representing to workers that they are subject to a noncompete where the employer "has no good faith basis to believe that the worker is subject to an enforceable non-compete agreement."
- **Bill Int. No. 146** – This bill proposes a ban on noncompetes with any low-wage employee, defined broadly to cover those identified in Section 190 of the New York Labor Law, and provides an exception for certain "bona fide executive, administrative or professional" employees whose earnings exceed $1,300 per week. Employers would be required to disclose to employees who do not meet the low-wage classification that they may be subject to a noncompete at the beginning of the hiring process, which presumably means that, at a minimum, it would have to be provided prior to making an offer of employment.
- **Bill Int. No. 375** – This bill would ban noncompetes with freelance workers, subject to certain exceptions, such as lawyers and licensed medical professionals. Such noncompetes would be prohibited unless the agreement requires the hiring party to pay a "reasonable and mutually agreed upon sum" to the freelance worker on either a bi-weekly or monthly basis for the duration of the noncompete. Failing to provide this payment will render the noncompete null and void. The proposal also provides for a private right of action, in which workers may obtain a declaratory judgment that the noncompete is void and recover attorneys' fees and statutory damages of $1,000 per violation.

Next steps

Washington employers should review their noncompete agreements now to ensure compliance with the amendment. This review should include any nonsolicitation covenants to ensure compliance with the newly narrowed exception for nonsolicitation agreements and expanded definition of noncompete agreements. Employers also should be sure to provide notice of the noncompete or the agreement itself with any offers of employment, including those made verbally. Since the amendment is retroactive, employers with current or former employees subject to potentially noncompliant nonsolicitation and noncompete provisions should contact counsel to discuss next steps.

In the likely event the FTC rule is finalized, as mentioned, it will most certainly immediately face legal challenges. However, employers should not wait by the sidelines for these legal challenges to play out. Employers should take proactive steps now to carefully evaluate their use of noncompete agreements, including the business justifications and goals for imposing such restrictions and the range of employees for whom such covenants are imposed. In particular, noncompetes should be narrowly tailored to protect legitimate business interests. Employers also should consider alternative means of protecting sensitive or confidential business information or intellectual property. Specifically, employers should identify their trade secrets and make sure that the appropriate steps are taken to preserve their secrecy, given the possibility that employers may not be able to rely on noncompete provisions as the primary measure to protect them.

Further, employers should identify their key employees and consider additional or alternative contractual protections (such as forfeiture for competition) to avoid unfair competition from competitors related to this top talent. While the pendulum may be swinging toward more prohibitions on noncompete agreements, this trend may be running into some pushback, as seen in Maine and New York. However, at the federal level, there appears to be continued efforts on this front. For example, even the Federal Deposit Insurance Corporation (FDIC) has stepped into the fray. On March 21, 2024, **the agency proposed an update to its Statement of Policy on Bank Merger Transactions**, which would generally prohibit a selling institution from entering into or enforcing any existing noncompete agreements with any employee of a divested entity. As more states and agencies seek to restrict the use of noncompetes, those using restrictive covenants should closely monitor developments in this space.

Employers with questions about the use of restrictive covenants should contact their Cooley employment lawyers.

Key Contacts

Anna Matsuo New York	amatsuo@cooley.com +1 212 479 6827

Joseph Lockinger Washington, DC	jlockinger@cooley.com +1 202 776 2286
Carly E. Gibbons Chicago	cgibbons@cooley.com +1 312 881 6613
Virat Gupta Washington, DC	vgupta@cooley.com +1 202 962 8362
Wendy Brenner Palo Alto	brennerwj@cooley.com +1 650 843 5371
Leslie Cancel San Francisco	lcancel@cooley.com +1 415 693 2175
Helenanne Connolly Reston	hconnolly@cooley.com +1 703 456 8685
Ross Eberly Santa Monica	reberly@cooley.com +1 310 883 6415
Joshua Mates San Francisco	jmates@cooley.com +1 415 693 2084
Carly Mitchell Washington, DC	cmitchell@cooley.com +1 202 842 7828
Gerard O'Shea New York	goshea@cooley.com +1 212 479 6704
Miriam Petrillo Chicago	mpetrillo@cooley.com +1 312 881 6612
MaryBeth Shreiner Reston	mshreiner@cooley.com +1 703 456 8169
Laura Terlouw San Francisco	lterlouw@cooley.com +1 415 693 2069

Ryan Vann Chicago	rhvann@cooley.com +1 312 881 6640