NOW + NEXT

EMPLOYMENT LAW ALERT | NIXON PEABODY LLP

AUGUST 3, 2018

Non-competition reform in Massachusetts

By David S. Rosenthal and Matthew T. McLaughlin

After years of trying and failing to reach agreement, on August 1, 2018, the Massachusetts House and Senate passed compromise legislation to restrict the use of noncompetition agreements in Massachusetts. If the bill is signed by Governor Baker, as expected, it will become effective October 1, 2018. A careful review of the bill reflects that for those in favor of reining in the use of noncompetition agreements, certain provisions of the legislation will accomplish that goal. In other respects, however, the law is consistent with Massachusetts common law and thus will likely not change Massachusetts practice substantially.

Many restrictive covenants are not affected

The statute expressly only applies to non-competition agreements between employers and employees and does not cover several other types of restrictive covenants, such as: (i) non-disclosure agreements, which prohibit the use or disclosure of a company's trade secret, confidential or business information; (ii) non-solicitation provisions, which may seek to bar the solicitation of a company's customers, prospects, suppliers or vendors, and/or may seek to prohibit the solicitation of the company's employees; or (iii) assignment of invention agreements, which require that inventions belong to the company and may not be used by a departed employee or disclosed to his or her new employer.

These commonly used restrictions will continue to be analyzed according to existing Massachusetts law, and will be enforced if the employer can establish the long-established requirements of this state's law. Many employers consider these types of restrictions sufficient to protect their trade secrets and other legitimate business interests.

In addition, two types of non-competition provisions can be enforced because they are expressly not covered by the new law. Non-competition agreements imposed in connection with the sale of a business remain enforceable. Importantly, non-competition restrictions agreed upon as part of a severance agreement can be enforced, provided the employee is given at least seven days to revoke his or her acceptance of the provision after signing it.

If signed, the new law will become effective on October 1, 2018, and will apply to agreements entered into on or after that date. Thus, existing non-competition agreements entered into before that date would not be controlled by the new law.

The new restrictions

The new law does apply to traditional non-competition provisions. The statute defines a non-competition provision as one in which an employee agrees that he or she will "not engage in certain specified activities competitive with" his or her employer after the employment relationship terminates. The law also applies to so-called forfeiture-for-competition provisions, which, in substance, dictate that if a former employee competes with his or her employer, he or she forfeits certain valuable rights or benefits, such as the right to deferred compensation or stock options. The former employee can compete, but if she does so, she pays a price for the opportunity.

Non-competition provisions, under the new law, cannot be used at all with (a) non-exempt employees (as defined by the federal Fair Labor Standards Act), (b) student interns or short-term employees at the undergraduate or graduate level and (c) employees who are 18 years of age or younger. Also, non-competition restrictions cannot be enforced against employees who are terminated "without cause" or are laid off. The statute does not define "cause," so the definition of the term, which can be the subject of substantial negotiation (especially in employment agreements of high-level employees) will become particularly important in agreements going forward.

Employers also cannot "contract around" the new restrictions by including a choice of law provision in their employee agreements providing for the application of another state's laws so long as the employee, for at least 30 days before termination, resides or is employed in Massachusetts.

Other important provisions

The act sets out various procedural requirements that must be followed if a non-competition provision covered by the new law can be enforced. Most important:

- The restriction on competition cannot exceed 12 months. This duration can be extended up to 24 months if the employee is found to have breached his or her fiduciary duty to the employer or if he or she absconded with the employer's property.
- The agreement must provide for a "garden leave" during the period of restriction, or must provide for some "other mutually-agreed upon consideration." Under the "garden leave" provision, the employer must pay the restricted employee at least 50% of the employee's annual base salary (at the highest level during the past two years) for the restriction period. The "other mutually-agreed upon consideration" provision could effectively eviscerate the "garden leave" provision given that the amount of such consideration is not defined. Employers could, therefore, include in their standard noncompetition agreements a "consideration" amount far less than 50% of the employee's base salary.
- If the agreement at issue is entered into at the inception of employment, the new law requires that the employer give the agreement to the new employee by the earlier of the time the offer is

extended or 10 days before the date of hire. This advance notice requirement is consistent with existing best practice; many employers do this already to avoid surprise and duress defenses that employees often can raise if the restrictions are not presented prior to the start date. If, on the other hand, the agreement is entered into during the course of employment, the employer must provide the existing employee with consideration for his or her signature on the agreement. This new consideration must be something of value, and not just a promise of continued employment, which is a departure from existing Massachusetts law. However, this will likely not be a troublesome or expensive provision for most employers. In this post-hire situation, too, the advance notice requirements apply.

- Existing Massachusetts law requiring an employer to demonstrate that the agreement is no broader than necessary to protect the employer's legitimate business interests—trade secrets, confidential information or goodwill—remains in effect. The geographic scope of the agreement must also be reasonable. Where the scope is defined as the territory in which the employee "provided services or had a material presence or influence" during the past two years, that geographic scope will be regarded as presumptively reasonable. Similarly, the agreement must be reasonable in terms of the scope of services that are restricted. If the restricted activities are limited to the types of services that the employee provided to the employer during the past two years, the reasonableness requirement is presumptively satisfied.

In sum, while the legislation will impose new burdens on employers, most employers should be able to comply with them without significant trouble or expense. Indeed, earlier proposed versions of the bill imposed far more onerous restrictions on the use of non-competition agreements, including an outright ban, as is the case in California. Legitimate questions exist as to whether this compromise reform legislation will accomplish the primary economic argument touted by proponents of the bill—to make Massachusetts more competitive with California in this technology-driven economy. It is also unlikely that the legislation will reduce litigation between employers and former employees (and often their new employer) when there are disputes—as there often are—regarding the enforceability of a non-competition agreement, as such disputes are heavily fact-driven by, for example, the employer's industry and the various circumstances surrounding the employee's past and new job duties. These fact-driven disputes will still have to be resolved in court.

Adoption of Uniform Trade Secrets Act

The legislation also will codify a version of the Uniform Trade Secrets Act ("UTSA"), bringing Massachusetts in line with every other state—other than New York—which has already adopted some form of the UTSA. Among other changes to existing Massachusetts law, the UTSA would allow for an aggrieved party to obtain an injunction for the *threatened* or actual misappropriation of a trade secret and also provides the court discretion to award attorneys' fees and costs to a prevailing party if a claim of misappropriation is made in bad faith.

Next steps for employers

It is expected that Governor Baker will sign the legislation, and, if he does so, it will become effective October 1, 2018. In the meantime, employers should consider taking the following steps:

- Review your current agreements carefully to determine whether they should be revised to comply with the new statute. As noted above, non-competition agreements entered into before October 1 are not governed by the new law. There are, nevertheless, at least two reasons to consider also revising these agreements. First, for many employers there is an administrative ease and advantage to having one, rather than two or more, forms of agreement. Second, it is possible that courts will be more hesitant to enforce provisions that are out-of-line with the requirements of the new law, regardless of the effective date of the statute. Courts are often asked to enforce restrictive covenants in injunction proceedings where they are acting as courts of "equity" and thus have substantial discretion to set the terms under which they will be enforced, if at all. The "blue-pencil" rule under existing Massachusetts law—giving the court the power to modify overly broad restrictions to make them reasonable, and thus enforceable—remains in the new law. Employers should further consider making changes in existing agreements to conform to the new statute at the time an employee is offered a raise or a promotion, as those benefits to the employee may satisfy the "other mutually-agreed upon consideration" requirement of the statute.
- Consider whether you need a non-competition restriction at all if the other types of restrictive covenants described above—which are not covered by the new law—will suffice to protect your business information and relationships. Depending on the outcome of that review, begin the process of making the changes that are necessary to protect the business and to comply with the new law.

These next steps are crucial for those organizations that rely on restrictive covenants to protect their businesses. This statute, like many others, leaves open a number of important questions, the answers to which may not be provided by judicial decisions for some time. Counsel who work in this area of the law are best-suited to do this analysis and provide advice regarding the clear and less clear provisions of the new law. Where an employer has a real and legitimate need for restrictive covenants to protect its trade secrets, confidential information and goodwill from misuse by a departed employee, having the right agreement in place is an essential first step.

Experienced counsel who are part of Nixon Peabody's Labor and Employment group, are available to assist you in this analysis, and to draft the provisions needed to comply with the changes in Massachusetts law.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

- David S. Rosenthal, 617-345-6183, **drosenthal@nixonpeabody.com**
- Brian V. Alcala, 312-977-4366, **bvalcala@nixonpeabody.com**
- Matthew T. McLaughlin, 617-345-6154, **mmclaughlin@nixonpeabody.com**