Five Ways The New Rhode Island Noncompetition Agreement Act Could Impact Your Business

Description

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On July 15, 2019, Rhode Island's Governor signed into law the Rhode Island Noncompetition Agreement Act (the "Act"), limiting the enforceability of restrictive covenants with certain employees. Its limited applicability largely makes the law irrelevant, with a handful of critical exceptions. Unlike the Massachusetts law, there is no grandfathering provision – meaning agreements signed prior to the January 15, 2020 effective date are still subject to the law.

A LIMITED NUMBER OF EMPLOYEES ARE PROTECTED BY THE ACT

The Act only applies to noncompetition agreements with the following categories of employees:

- Employees who are classified as non-exempt under the Fair Labor Standards Act. As a reminder, employees cannot be classified as "exempt" unless they meet a specific duties test and guarantee compensation of $455 a week, $23,600 annually (employees cannot be paid hourly unless the employee falls under the narrow "computer employee" exemption"). That weekly rate is expected to be raised to $679 ($35,308) according to the Department of Labor's ("DOL") proposed regulations;
- Low-income employees, whose average annual earning is no more than 250 percent of the federal poverty level guideline for individuals established by the United States Department of Health and Human Services ("USDHHS") federal poverty guidelines. While not artfully drafted, this appears to refer to the USDHHS poverty guidelines for households of one, rather than requiring the employer to calculate the number of individuals in a particular employee's household and subtracting out incomes of other household members. Thus, in 2019, annual earnings need only exceed $31,225 to avoid the applicability of the Act ($39,000 in Alaska and $35,950 in Hawaii);
- Undergraduate or graduate employees working as interns or another category of short-term employment while enrolled at an educational institution; and
- Employees age eighteen (18) years or younger.

A LIMITED NUMBER OF AGREEMENTS ARE AFFECTED BY THE ACT

The Act applies to noncompetition agreements between an employee and an employer that arise out of either an existing employment relationship or an anticipated employment relationship in which the employee agrees to not engage in certain activities competitive with the employer following the end of the employment relationship. Such agreements include forfeiture for competition agreements (such as agreements to forgive loans or tuition reimbursement on the condition that the employee does not compete), however exclude:

- Nonsolicitation agreements (preventing solicitation of or doing business with customers or vendors);
- Nonpoach agreements (preventing hiring or solicitation of employees);
- Forfeiture agreements (except for forfeiture for competition agreements);
- Nondisclosure, confidentiality and invention assignment agreements;
- Noncompetes made in connection with a sale of a business where the employee is a significant owner, member or partner in the entity sold and is receiving significant consideration or benefit as a result of the sale of the business;
- Noncompetes outside of the employment relationship, such as independent contractor relationship. This provision potentially allows for noncompetes in connection with a sale (where the consideration is not

the employment but the sale proceeds itself) even if the individual signing the noncompete is not a significant owner of the business or the consideration received by the individual is not significant;
- Noncompetes in which the employee agrees not to reapply for employment with said employer after termination; and
- Noncompete agreements made upon the termination of the employment relationship, if there is seven (7) days to revoke (which generally will be severance agreement, as there has to be some consideration for the noncompetition agreement).

WHY IT MATTERS (AND WHY IT DOESN'T)

Overall, the Act's provisions concerning age, internships and low wages make noncompetition agreements unenforceable with low-level employees. Under current case law, such agreements are already difficult to enforce against those types of employees under common law principles, which limit the enforcement of noncompetition agreements to situations where a company has a real business interest in protecting its goodwill and confidential information. For business reasons, it is also rare that a company is looking to enforce such agreement against interns, minors, hourly paid and/or poverty-level employees.

Further, the Act explicitly does not make it illegal to ask for a noncompetition agreement (unlike California law), stating that inclusion of an unenforceable noncompetition provision does not invalidate the rest of the rest of the agreement. This is significant because even if the enforceability of your company's noncompetition provision is affected, it does not mean you need to revise the entire agreement so long as you understand that such provision will not be enforceable. That said, if you have agreements that contain such unenforceable provisions, you may consider making revisions because the inclusion of such provision may not sit well with employees – who do not like noncompetition provisions – and provide the company no value given the lack of enforceability.

With that considered, there are five notable implications to the Act.

1. Your company uses employee consultants or part time employees to provide vital business advice or functions, but are paid an hourly rate.

This arrangement is desirable when your Company has great, high level employees who work limited hours. For example, perhaps you have convinced the retiring CFO to work ten (10) hours a week to transition out of his or her role, or you made arrangements for your superstar account manager to work two (2) days a week because of the employee's desire to stay at home with his or her children. Whatever the case, these are exactly the individuals you may want to have a noncompetition agreement with given their seniority or job. Yet, if your arrangement is to pay them hourly – regardless of how high the rate is – they are nonexempt and any noncompetition agreement will be unenforceable. To avoid such unenforceability, you may consider paying them an annual salary over both the DOL salary basis test and 250 percent of the individual federal poverty level (over $31,225, annually, which is expected to soon be $35,208), despite the employee's limited hours.

2. You are a start-up paying employees entirely or partially with sweat equity.

Noncompetition agreements are often essential for start-ups. For those blossoming, new organizations out there that are still "paying" people in violation of the wage and hour laws by providing sweat equity in exchange for services, this is just another reason – amid the myriad of legal reasons – to stop doing so, as the employees again would not be exempt if not paid a salary. In addition, for those start-ups who have heeded their counsel's advice and now pay such employees the bare minimum (minimum wage) plus equity – which is legal – you may have to revisit those arrangements and shell out the required annual $30,000 plus salaries to applicable workers.

3. Potential Judicial Interpretation Impacting Most Businesses.

There are some ambiguities to the Act. Specifically, the exception for nonsolicitation agreements and nonpoach agreements only speaks to "employees" "vendors" "clients" or "customers". If read literally, as opposed to in line

with how noncompetition agreements are generally written, this would leave covered employees able to poach former employees and former clients (who potentially quit or terminate their services a day prior to the hiring or solicitation and perhaps even with the intent to engage with the restricted employees). It also would mean covered employees could not be prevented from soliciting prospects – even if the company has been paying the employee to chase the particular lead and culminate the relationship with the prospect. An interpretation to that end would likely impact many more businesses, as nonsolicitation and nonpoach agreements are more likely to be signed by lower-level employees.

4. Increasing Thresholds for Low-Wage Earners.

It is significant that the minimum salary threshold does not mirror the salary basis exemption. The proposed regulations raising the salary basis exemption, as well as the current law, do not automatically adjust the salary amount. Thus, while the low earner salary level in the Act ($31,225) is very close to the salary basis exemption level now, it will increase every year as the USDHHS publishes new figures annually. In contrast, the salary basis exemption test, if increased in 2020 as proposed, would be the first increase since 2004. In contrast, in 2004 the USDHHS poverty level for a single household was $9,310. Thus, while the low earner income threshold in the Act currently may not seem meaningful, in the years to come as it automatically rises, the provision will increase in significance.

5. Adding a Revocation Period for Severance Agreements Containing Restrictions.

Finally, for employers who use severance agreements containing noncompetition provisions, a seven (7) day rescission period will need to be added, as the same would not normally be included if the employee receiving the agreement is under forty (40) years old.

LOOK AT YOUR NONCOMPETITION AGREEMENTS NOW

Employers will need to review their noncompetition agreements to determine if existing restrictive covenants fall into any of the categories affected by the Act, and if so, consult with their employment counsel to determine the best course of action to protect their business given the Act.

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