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New Massachusetts Law Limits Use of Noncompetition Agreements

October 26, 2018

On August 10, 2018, Massachusetts Governor Charlie Baker signed into law an act relative to the judicial enforcement of noncompetition agreements that fundamentally changes the way those agreements are regulated in Massachusetts. The act applies to all noncompetition agreements entered into after October 1, 2018, so all employers that have Massachusetts-based employees who are subject to restrictive covenants should review their current employment practices immediately.

Agreements to Which the Act Applies

The act defines a covered noncompetition agreement as any agreement "between an employer and 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."

Covered noncompetition agreements also include so-called "forfeiture for competition agreements," which are agreements that impose adverse financial consequences on separated employees who engage in competitive activities. Although this definition references employees, the act also expressly applies to independent contractors (for convenience and clarity, we use the term "employee" throughout this article, but the act applies equally to independent contractors).

Agreements to Which the Act Does Not Apply

The act does not apply to (a) agreements not to solicit or do business with customers or vendors of the employer; (b) covenants not to solicit for hiring or covenants not to actually hire employees of the employer; and (c) confidentiality/invention assignment agreements. Despite these carve-outs, it is possible that the act will be interpreted to cover nonsolicitation or nonpoaching agreements that extend beyond the basic protections described above. For many employers, the continued permitted use of nonsolicitation and nonpoaching agreements, even with a more narrowly tailored scope, will make adapting to the act easier and less disruptive to their businesses.

The act also does not apply to certain noncovered noncompetition agreements, which are unrestricted by the act and will remain regulated under common law standards. Noncovered noncompetition agreements include the following:

1. 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.

2. Noncompetition agreements outside of an employment or independent contractor relationship.

3. 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.

4. Any agreement signed prior to October 1, 2018.

Although the act does not apply to agreements entered into prior to October 1, 2018, courts often consider public policy objectives when deciding whether or not to enforce noncompetition agreements. The passage of the act sends a clear signal that Massachusetts' public policy is in favor of limiting the use of noncompetition agreements. The Massachusetts Supreme Judicial Court has indicated a willingness to rely upon a statute as evidence of

public policy, even where the statute does not apply to the agreement at issue. Massachusetts courts might therefore render unenforceable for reasons of public policy even those noncompetition agreements entered into prior to October 1, 2018.

Prohibited Agreements

Covered noncompetition agreements are invalid and not enforceable against employees who have been laid offor terminated without cause and employees who are classified as nonexempt under the Fair Labor Standards Act. It is therefore particularly important for employers to make an accurate determination as to whether or not each employee subject to a noncompetition agreement is an exempt employee. This can be a fact-intensive analysis that is dependent on each employee's salary and duties. It is also worth noting that the act makes noncompetition agreements unenforceable against undergraduate or graduate students who are engaged in a short-term engagement and workers who are 18 years of age or younger.

Enforceability of Covered Noncompetition Agreements

In order for a covered noncompetition agreement to be enforceable under the act, it must meet the following structural and procedural requirements:

1. The agreement must be in writing and signed by both the employer and the employee, and expressly state that the employee has the right to consult with an attorney.

2. If the 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 the employee's employment, whichever is earlier.

3. If the agreement is presented after the commencement of employment, notice of the agreement must be provided at least 10 business days before the agreement is to become effective.

4. The agreement is invalid unless it is supported by either "garden leave" pay or some "other mutually-agreed upon consideration." The act is clear that merely offering continued employment is not sufficient consideration for imposing a noncompetition agreement after the employee has been hired. It is less clear whether additional consideration is required in order for a noncompetition agreement entered into at the time of employment to be valid. The act also does not define "other" consideration, so there is no guidance as to the type or amount of consideration that is sufficient as "other" consideration. The act does define garden leave pay, which must be paid for the duration of the postemployment restriction period, as "at least 50% of the employee's highest annualized base salary paid by the employer within the two years preceding the employee's termination."

5. The applicable portion of the agreement subject to the act may not exceed 12 months from the date of cessation of employment (unless a limited exception applies).

6. The restriction 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."

7. The restriction must be limited to the specific type of services the employee provided to the employer during the last two years of employment.

8. The employer must also be able to demonstrate that no other type of restrictive covenant is sufficient to protect the "legitimate business interests" of the employer. Under the act, the legitimate business interests of an employer are limited to protecting trade secrets, confidential business information and goodwill.

Conclusion

Although the act makes it more difficult to enter into a valid and enforceable noncompetition agreement, it leaves open the possibility of using narrowly tailored nonsolicitation and nonpoaching agreements to accomplish many of the same purposes. Rather than attempt to shoehorn employees into noncompetition agreements that may prove unenforceable or costly, many employers will benefit from strategically utilizing alternative restrictive covenants. In those scenarios where noncompetition agreements are truly essential, employers should be prepared to pay the

employee for the right to impose restrictions and should be careful to implement an agreement that complies with the notice, consideration, duration and geographic requirements of the act.

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