Legal Update for Business Owners

New Washington Non-compete Bill:

Many Covenants for Employees and Independent Contractors Unenforceable

Engrossed Substitute House Bill 1450

Effective Date: January 1, 2020

Non-compete covenants are designed to protect your company and are meant to protect businesses owners from former employees or independent contractors leaving and working for a competitor or opening a competing business. These protections have just become more limited for business owners as a result of new legislation recently signed by Governor Inslee. As a business owner, you'll want to check your non-compete covenants and see that they comply with the new law.

Last month, Governor Inslee signed a bill, which limits the scope and enforceability of non-compete agreements in Washington. The bill includes provisions relating to moonlighting restrictions and franchise agreements as well. Any action to enforce these provisions that starts on or after January 1, 2010, will be subject to this new law, regardless of when the non-compete was entered into or when the cause of action arose. **This means it applies to existing non-compete agreements, which may have been signed years ago.**

What is a non-compete covenant?: It is defined as a 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.

A non-compete covenant does not include:

- Non-solicitation agreements limiting former employees from soliciting customers to stop or restrict business with the company
- Non-solicitation agreements limiting former employees from soliciting former coworkers to leave the company
- Confidentiality provisions
- Prohibitions on use or disclosure of trade secrets
- Non-compete agreements entered into at the sale of a business
- Non-competes by a franchisee when the franchise sale complies with RCW 19.100.020(1)

New Income Threshold

Non-compete covenants will be unenforceable unless the employee's W-2 earnings are more than $100,000/year (on the date the employer seeks to enforce the covenant or the date employment ends, whichever occurs first) or an independent contractor is paid more than $250,000/year for the prior year). These amounts will be adjusted annually for inflation.

For most startups, this means you will not be able to enforce non-compete agreements against employees or independent contractors, unless you pay them a significant amount of money. For

example, if you hired someone for an annual salary of $75,000, you won't be able to enforce a non-compete covenant against them.

Newly Established Time Limit

This new law creates a presumption any non-compete covenant longer than 18 months is unreasonable and unenforceable. This presumption is only overcome by clear and convincing evidence a longer duration was necessary to protect the employer's business or good will. Most employers will need to limit non-compete agreements to 18 months.

There is an exception to certain aspects of the statute for "performers," which we believe is likely related to actors and others who perform on stage.

New Liability for Damages and Attorney Fees, Even if the Noncompetition Covenant is Enforced

Regardless of whether the Attorney General, former employee, former independent contractor, or your company files suit regarding the non-compete covenant, if a court or arbitrator rules that the covenant violates the new law or has to modify even a minor part of the agreement to make it enforceable, the company will have to pay the greater of $5,000.00 or actual damages, plus attorneys' fees, expenses, and costs to the employee.

While businesses are free to modify or create new non-compete covenants to comply with these new requirements, the business could still be responsible for paying attorneys' fees and costs when it comes time to enforcing these covenants.

New Protection for Laid Off Employees Requiring Ongoing Compensation

The reasoning behind non-compete covenants is to help employers prevent an employee from learning valuable business information one week and then leaving with their new found knowledge to work with a competitor the following week.

The new bill tries to address a situation where the employee is laid off and prohibited from working for any competitor for the next year and half because of what they learned. Thus, the new law requires that to enforce a non-compete against an employee who is terminated because of a layoff, the employer must pay the employee their base salary during the enforcement period, less any earnings the employee earns through subsequent employment during that period.

For example, if you hire someone for $50,000/year and you lay them off three months later. If you want to enforce the non-compete covenant against them saying they can't work in your industry for the next year and half, you'll need to continue paying them their salary (minus any earnings they have from another job not in the industry).

New Limits on Forum Shopping and Choice of Law

This limit prevents employers from using another state's law to govern the agreement and litigate it in that state instead to avoid these new Washington restrictions. Provisions in non-compete agreements with Washington based employees and independent contractors are going to be void if they require disputes to be adjudicated outside of Washington or if they deprive the person of the protections under the new law.

New Disclosure and Consideration Obligations

The non-compete covenant has to be disclosed in writing to a prospective employee no later than the time they accept an offer of employment, even if the non-compete becomes enforceable only at a later date because of an increase in the employee's pay in the future.

If the employee is asked to sign a covenant after already starting work and being paid, the employer will have to pay independent consideration, such as a raise or a bonus, for it to be enforceable.

New Restrictions on Franchisors/Franchisees

This bill prohibits franchisors from restricting franchisees from soliciting or hiring employees of the franchisor or another franchisee.

However, the new law excludes noncompetition covenants entered into by a franchisee, if the franchise sale is registered properly per Washington's Franchise Investment Protection Action, or is exempt from registration. A franchisor should still carefully consider whether its operation falls within the definition of an employment relationship under RCW 49.17.020 when it is attempting to enforce a non-competition agreement against a franchisee.

New Restrictions on Prohibiting Employees from Moonlighting

Starting January 1, 2020, this bill prohibits anti-moonlighting restrictions against employees who earn less than twice Washington's minimum wage, with some limited exceptions. Under the new law, an employer cannot restrict or prohibit an employee that earns less than $27.00 in 2020 from having a second job, working as an independent contractor, or being self-employed. The minimum wage in Washington State will be $13.50 in 2020 and will be adjusted annually for inflation so this $27.00 pay level will change each year.

However, employers can still prohibit moonlighting where it would cause issues of safety for the employee, coworker, or the public, or it would interfere with the employer's reasonable and normal scheduling expectations. An employer could also prohibit an employee from moonlighting at a job where it would present a conflict of interest because the employee still continues to have a duty of loyalty and there are laws preventing conflicts of interest.

Impact on You as a Business Owner

This new bill seems to reduce the chance for startups to use non-compete agreements because startups typically have low capital and pay low compensation to employees and independent contractors or they will often compensate only through equity, which would make non-compete covenants almost impossible to enforce.

This will likely make it more costly for business owners to enforce the non-compete agreements because an employer could end up paying all of employee's litigation fees even with an enforceable agreement if it has to be enforced through the legal system.

Do keep in mind, the employer does still have protections available to it, including the Uniform Trade Secrets Act, which will prohibit a former employee from taking trade secrets and exploiting them through a competitor.

As a business owner, you should review any existing agreements and policies to ensure they will pass legal muster after January 1, 2020 and put yourself in a better position to negate employee arguments that the agreements are excessive in scope and thus unreasonable.

Pivotal Law Group recommends all employers who utilize non-compete agreements in their business to contact us as soon as possible to review your forms and formulate a strategy for how to address the impacts of this law with existing employees and future employees.

Please contact either managing member Chris Thayer at (206) 805-1494 or CThayer@PivotalLawGroup.com, or senior associate Kim Sandher at (206) 805-1490 or KSandher@PivotalLawGroup.com.

A full copy of the bill is available here.