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Client Alert Commentary

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Washington State's Noncompetition Law: What Employers Need to Know

The new state law reflects a trend among other states including New Hampshire, Maine, Maryland, Oregon, and Rhode Island to enact noncompetition legislation.

Key Points:

Under Washington State's new noncompetition law, effective January 1, 2020:

- Noncompetition covenants are only enforceable with employees who earn in excess of $100,000 per year and independent contractors who earn in excess of $250,000 per year.
- Any noncompetition covenant exceeding 18 months post-termination is presumed to be unreasonable and unenforceable.
- If an employee is terminated as a result of a layoff, they must be compensated during the noncompetition period in order for the covenant to be enforceable.
- Employers must disclose mandatory noncompetition covenants to prospective employees no later than the time the candidate accepts the job offer, and independent consideration must be provided to existing employees entering into noncompetition covenants.
- Agreements requiring the application of non-Washington law or adjudication outside of Washington are void.
- Noncompetition covenants entered into before 2020 must comply with the new law.
- Employers face penalties for noncompetition covenants that do not comply with the new law.

Introduction

On May 8, 2019, Washington State Governor Jay Inslee signed into law H.B. 1450, which, among other requirements, limits the enforceability of noncompetition covenants against employees. With the passage of the law, Washington joins other states, including more recently, New Hampshire, Maine, Maryland, Oregon, and Rhode Island, in placing restrictions on the use of such agreements.

The new law will go into effect on January 1, 2020. To prepare for this implementation, employers must address the following questions:

Which restrictive covenants are covered by the new law?

The new law applies to noncompetition covenants, which are broadly defined as any written or oral covenant, agreement, or contract that prohibits or restrains an employee or independent contractor from

engaging in a lawful profession, trade, or business of any kind. The law specifically excludes from the definition of "noncompetition covenant" the following types of agreements and provisions:

- Customer or employee non-solicitation agreements
- Confidentiality agreements
- Covenants prohibiting the use or disclosure of trade secrets and inventions
- Covenants entered into by an individual purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest
- Covenants entered into by a franchisee when the franchise sale complies with certain registration requirements under Washington State law. (Note that pursuant to the law, franchisors may not restrict, restrain, or prohibit a franchisee from soliciting or hiring any employee of the franchisor or of a franchisee of the franchisor.)

Who can be subject to a noncompetition covenant?

Under the new law, employers will only be able to enforce noncompetition covenants against an employee if the employee earns more than $100,000 in a year, or in the case of an independent contractor, if the contractor earns more than $250,000 in a year (these amounts will be adjusted annually for inflation).

Are there timing and consideration requirements?

Yes. Employers must disclose the terms of the noncompetition covenant in writing to prospective employees no later than the time the candidate accepts an employment offer. Alternatively, employers may choose to draft the noncompetition covenant to become enforceable at a later date due to changes in the employee's compensation (as discussed above), provided the employer specifically states that the noncompetition covenant may be enforceable against the employee in the future.

If the noncompetition covenant is entered into after the start of employment, the agreement must be supported by independent consideration, *i.e.*, continued at-will employment will not be sufficient consideration. The new law does not define what constitutes independent consideration.

Does the new law allow employers to restrict outside employment during employment?

It depends. The new law states that an employer may not prohibit an employee earning less than twice the applicable state minimum hourly wage from having an additional job during their employment, sometimes referred to as moonlighting. Exceptions may apply regarding issues of safety, and if outside employment would interfere with the reasonable and normal scheduling expectations of the employer. Additionally, the law does not alter the applicable common law obligations that exist, such as the duty of loyalty, or laws and policies preventing conflicts of interest.

Is there a limitation to the temporal restriction?

Yes. A noncompetition covenant that exceeds 18 months following the termination of the employment or engagement will be presumed to be unreasonable and unenforceable under the law. A longer temporal restriction must be supported by clear and convincing evidence that it is necessary to protect the employer's business or goodwill.

Is compensation during the post-termination restricted period required?

Generally, no. Compensation during the post-termination restricted period, often called garden leave, is not required. If an employee is terminated as a result of a layoff, however, employers will not be able to enforce the noncompetition covenant unless the employee is paid an equivalent of their base salary

during the noncompetition period (minus any compensation earned through subsequent employment by the employee during this time). Therefore, employers are encouraged to include a clause that would require the employee to notify them of compensation earned during the restricted period, to allow them to offset the garden leave as the law permits.

Can a noncompetition covenant require adjudication outside of the state or application of non-Washington law?

No. The law states that Washington-based employees or contractors cannot be "deprive[d] … of the protection or benefits of [Washington law]." Additionally, under the law, a covenant that would require Washington-based employees or contractors to adjudicate a noncompetition covenant in a forum outside of Washington State is void and unenforceable.

Are there penalties for non-compliance with the law?

Yes. The new law provides for penalties if a noncompetition covenant does not comply. The law provides a private right of action for a person who is a party to a noncompetition covenant that does not comply with the law, and the state attorney general can pursue action on behalf of any aggrieved individual. Penalties include the greater of actual damages or a statutory penalty of $5,000, plus reasonable attorneys' fees, expenses, and costs.

Notably, even if a court or arbitrator decides to partially enforce an unlawful noncompetition covenant after January 1, 2020, the employer will still be subject to the penalties listed above.

As such, employers should carefully review current noncompetition covenants against the provisions of the law to assess compliance. This may require the employer to draft new covenants or forego enforcement of any current noncompetition covenants after January 1, 2020.

Are pre-2020 noncompetition covenants subject to the new law?

Yes. Pre-2020 noncompetition covenants are subject to the new law. However, penalties will be assessed against the employer only if they attempt to enforce an *unlawful* noncompetition covenant post-2020.

The law states that "a cause of action may not be brought regarding a noncompetition covenant signed prior to [January 1, 2020] if the noncompetition covenant is not being enforced." Therefore, if an employer has a *unlawful* covenant drafted prior to the effective date of the new law, the employer will be subject to penalties only if they attempt to enforce this unlawful covenant against an employee after January 1, 2020.

Other States' Noncompetition Legislation

Other jurisdictions continue to enact legislation related to noncompetition agreements. Employers should note the following recently enacted laws and their effective dates:

New Hampshire: Now in effect, S.B. 197 prohibits noncompetition agreements for lower wage workers.

Maine: Now in effect, H.B. 733 prohibits noncompetition agreements for lower wage workers and imposes additional requirements impacting agreements between those earning above the set income level.

Maryland: Now in effect, S.B. 0328 prohibits certain noncompetition and conflict of interest provisions for lower wage workers.

Oregon: Effective January 1, 2020, H.B. 2992 will require a signed, written copy of the terms of the noncompetition agreement given to the employee within 30 days after the date of the employee's termination.

Rhode Island: Effective January 15, 2020, S.B. 0698 will prohibit noncompetition agreements for certain workers, including lower wage workers and nonexempt employees.

Conclusion

Employers with employees in Washington State should carefully review their current noncompetition covenants and determine if the covenants meet the requirements of the new law. Multi-state employers should always consider any applicable state restrictive covenant laws, but should further note the trend as other states pass statutory noncompetition legislation. Latham & Watkins will continue to monitor developments in this area.

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