Updates
April 22, 2019

Washington State Poised to Impose Significant Restrictions on Noncompetition Agreements

Last week, the Washington State Legislature passed a proposal that, once signed into law, will significantly restrict the use of noncompetition agreements in Washington. We fully expect Governor Jay Inslee to sign this law, which will then take effect January 1, 2020. Once the law is in effect, the use of noncompetition agreements for Washington-based employees and independent contractors will be scaled back and enforcement actions for lawful agreements will become more costly—and risky—for employers.

Legal Background

Unlike some states, such as California, Washington law has generally permitted noncompetition agreements, and Washington courts will generally enforce them to the extent necessary to protect an employer's legitimate business interests. Washington law has followed the rule of reasonableness, which means that even if a court concludes that some aspect of a particular noncompete agreement is not reasonable, such as its duration, the court has the authority to "reform" the agreement—narrowing it down to what the court decides is a more reasonable scope.

All of that will change dramatically once Engrossed Substitute House Bill 1450, which passed the Legislature on April 17, is signed into law by Governor Inslee.

What Will the New Law Change?

Quite a bit.

First, the new law will prohibit all noncompetition agreements for employees whose W-2 earnings are less than $100,000 annually. It will also prohibit noncompetition agreements with independent contractors who receive less than $250,000 per year from the other party to the agreement. Going forward, these dollar thresholds will be adjusted annually for inflation.

Second, noncompetition agreements that last more than 18 months will be presumed unreasonable, and that presumption will only be overcome by proving with clear and convincing evidence that a longer duration was necessary to protect the employer's business or goodwill. (The duration of noncompetition agreements with performers in the entertainment industry will be limited to 3 days.)

Third, in order to enforce a noncompetition agreement against an employee who is let go as a result of a "layoff" (a term that the law does not define), the employer must pay the employee his or her base salary during the period of enforcement, less any earnings the employee receives from subsequent employment.

Fourth, provisions in noncompetition agreements with Washington-based employees and independent contractors will be void if they require that disputes be adjudicated outside Washington or if they deprive the person of the protections under the new law.

Fifth, a proposed noncompetition agreement will have to be disclosed to a prospective employee no later than the time of the person accepts an offer of employment. And, if the agreement becomes enforceable only at a later date due to changes in the employee's pay, the employer must specifically inform the person that the agreement may be enforceable in the future.

Sixth, in an action to enforce a noncompetition agreement (or in a declaratory judgment action by the employee challenging the agreement), if a court or arbitrator determines that the agreement violates the new law, or if the judge/arbitrator reforms, rewrites, modifies or only partially enforces it, the employer must pay the employee the greater of $5,000 or his/her actual damages, plus the employee's reasonable attorneys' fee, expenses and costs incurred in the proceeding.

The legislation contains two other restrictions that are not related to noncompetition agreements:

- It will prohibit franchisors from restricting franchisees from soliciting or hiring employees of the franchisor or another franchisee; and
- It will prohibit anti-moonlighting restrictions for employees who earn less than twice Washington's minimum wage, with certain limited exceptions.

On the positive side, the new law will not restrict nonsolicitation or confidentiality agreements, agreements related to trade secrets or inventions, or agreements by a person buying or selling an ownership interest in a business.

If signed into law, the new law will take effect January 1, 2020, and it will apply to any legal action that is commenced on or after that date. This may mean that the new restrictions will be imposed on pre-existing agreements in any enforcement action that is initiated on or after January 1, 2020.

Takeaways for Employers

This is a major change for Washington employers. Due to the compensation thresholds, the new law will significantly reduce the chance for startups to use noncompetition agreements, as those employers tend to pay relatively low W-2 compensation, even for key personnel, and instead compensate through equity.

All Washington employers will be well advised to review their existing agreements and employment policies to be sure they will pass legal muster after January 1, 2020.

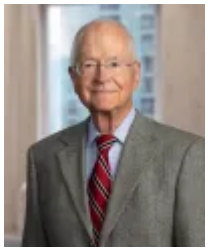
In addition to significantly limiting when noncompetition agreements will be permitted, the new law will make enforcement of even legal agreements riskier. This is because it is not uncommon for a court or arbitrator to find some aspect of an agreement to be overly broad (such as how long the noncompetition restriction can remain in effect), yet enforce it to the extent it would be reasonable. In those cases, the employer largely accomplishes what it wants and achieves most of the protection it sought with the agreement, but under the new law, if that happens, the employer may be obligated to pay all of the employee's litigation fees and costs—thereby doubling the legal costs of enforcement.

To mitigate that risk, employers would be wise to carefully review their noncompetition agreements and to restrict their scope to be in a better position to refute employee arguments that the agreements are unreasonable because of their excessive scope.

Finally, because nonsolicitation, confidentiality and trade secret agreements will still be permissible, consideration should be given to reviewing them as well, because carefully drafted agreements on those topics

will provide much of the protection employers seek with noncompetition agreements.

Authors



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