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Massachusetts Passes Reform Bill to Limit Enforcement of Noncompetition Agreements

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After nearly a decade of false starts, Massachusetts has enacted reform legislation limiting the scope and enforceability of noncompetition agreements. The new law does not go so far as to "ban" such agreements, as some proponents of the reform had advocated, but it imposes several new drafting requirements that employers and employees alike should note, as it:

- Requires noncompetition agreements to include a clause providing that the employer make "garden leave" payments to employees during the post-termination period, or, at a minimum, to specify "other mutually-agreed upon consideration" given in exchange for the employee's agreement not to compete
- Establishes strict rules about when and how employers may present noncompetition agreements to new employees in the hiring process and to existing employees
- Expressly governs noncompetition agreements with independent contractors
- Sets forth clear criteria to assess the reasonableness of the duration and scope of the period of noncompetition, which courts can use to determine whether the agreement is enforceable

In large part, however, the law simply codifies the existing common law standards for enforcement of noncompetition agreements in Massachusetts. The law also does not disturb or apply to non-solicitation agreements that restrict former employees' efforts to recruit to their new employers either customers or employees of their former company. Nor does the law govern nondisclosure or confidentiality agreements. Similarly, certain noncompetition agreements made in connection with the sale of a business remain outside the reach of the new law.

The bill goes into effect October 1, 2018, and applies only to noncompetition agreements entered into on or after that date. Existing noncompetition agreements are not impacted.

Noncompetition agreements must be no broader than necessary and designed to protect legitimate business interests

The law imposes several statutory restrictions on the enforceability of noncompetition agreements that parties should consider in drafting and reviewing new agreements.

First, as under existing law, the new law provides that noncompetition agreements must be "no broader than necessary" to protect the employer's "legitimate business interests," which includes trade secrets, confidential information, and goodwill, to the extent such interests cannot be "adequately protected through an alternative restrictive covenant, including but not limited to a non-solicitation agreement, non-disclosure agreement or a confidentiality agreement."

Second, the law sets a strict one year post-termination time limit on noncompetition agreements, declaring that noncompetition agreements with a longer temporal scope "shall not be valid or enforceable." The law does allow an extension of the restricted period to up to two years post-termination if an employee breached a fiduciary duty owed to the employer or misappropriated the employer’s physical or electronic property. While the strict nature of these temporal limits is new, they are aligned with the Massachusetts courts’ current approach, which typically only enforces noncompetition agreements for up to one and, in rarer cases, two years.

Third, the law deems the geographic scope of noncompetition agreements "presumptively reasonable" where

limited "to only the geographic areas in which the employee, during any time within the last two years of employment, provided services or had a material presence or influence." Again, although the new law adds definition and strict guidance where there previously was none, this new restriction is fairly consistent with the permissible geographic scope allowed by many courts in applying the common law standard.

Similarly, such agreements are deemed "presumptively reasonable" in terms of the scope of restricted activities where they are "limited to only the specific types of services provided by the employee at any time during the last two years of employment."

The new law includes a “garden leave” provision

Arguably the most novel provision of the law, which was not embedded or commonplace under the common law, is the requirement that noncompetition agreements include "a garden leave clause or other mutually-agreed upon consideration between the employer and the employee." A "garden leave" clause typically requires employers to pay ex-employees a sum while they are sidelined. The new law provides "for the payment … on a pro-rata basis during the entirety of the restricted period of at least 50 per cent of the employee's highest annualized base salary paid by the employer within the two years preceding the employee's termination."

The law nevertheless exempts employers from making "garden leave" payments in certain circumstances, such as where the employee breaches the agreement (i.e., by accepting competitive employment during the restricted period) or unlawfully takes the employer's property.

The law provides no guidance as to what "other mutually-agreed upon consideration" would satisfy the requirement in lieu of an agreement to make "garden leave" payments. Given the lack of guidance, the amount and type of consideration that will be deemed sufficient will likely be one of the most contested issues arising from the new law. Unless and until that issue is clarified in court decisions, employers and employees could conceivably agree to myriad alternative arrangements, such as signing bonuses or even non-monetary consideration, because the statute imposes no required minimum value.

The law introduces new employer obligations for notice and delivery of noncompetition agreements

Also in deviation from the common law, the new law creates separate requirements that depend on whether the noncompetition agreement is entered into *before* the commencement of employment or *after*. If signed *before* the commencement of employment, the agreement must have been provided to the employee either "before a formal offer of employment is made or 10 business days before the commencement of the employee's employment, whichever comes first."

As for agreements entered into *after* the commencement of employment, the law provides that they must be "supported by fair and reasonable consideration independent from the continuation of employment." In other words, the law requires the employer to provide consideration over and above merely allowing the employee to continue in his or her job. Massachusetts courts had previously been divided over whether continued employment would constitute sufficient consideration to support the agreement, and the new law appears to resolve that issue. The law further requires that notice of the agreement be provided "not less than 10 business days before the effective date of the agreement."

Regardless of timing, the law requires any noncompetition agreement to be in writing and signed by the employer and employee, and to state expressly that the employee has the right to consult with counsel.

Blue penciling remains allowed

- The law permits courts to, in their discretion, "reform or otherwise revise a noncompetition agreement so as to render it valid and enforceable to the extent necessary to protect applicable legitimate business interests." This practice of courts revising an agreement to render it enforceable when a certain situation or fact pattern arises (as opposed to striking an agreement that is unenforceable as written) is commonly known as "blue-penciling," and has long been the permitted practice of

Massachusetts courts

- The law continues to permit courts to fashion their own noncompetition restrictions "whether through preliminary or permanent injunctive relief or otherwise"
- Keeping with the current common law, the law makes clear that a finding that a noncompetition provision in a contract is unenforceable has no impact on the remaining provisions of the contract

Conclusion

The new law's true impact remains to be seen, but employers do need to take concrete steps to ensure their non-compete agreements remain enforceable.

Cooley will continue to monitor developments as the law takes effect, and will issue an update if necessary. In the interim, please contact a member of our team if you have any questions regarding the impact of this new law.

For further information about the noncompete law or related issues, please contact one of the attorneys listed here.

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