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"If at First You Don't Succeed...."

Bill Restricting Noncompetition Agreements Reintroduced in Massachusetts Legislature: What Employers Should Know

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In January, opponents of noncompetes (or noncompetition agreements) introduced a bill in the Massachusetts House of Representatives that, if adopted, would dramatically affect Massachusetts law governing the enforcement of noncompetes. A bill to create a "Noncompetition Agreement Act" was introduced in the Legislature in 2010 but died in committee. Sponsors have revised the bill; however, the thrust of the proposed new law, which applies only to noncompetes signed after the effective date of the law, is still to establish new rules governing the enforceability of noncompetes and to impose harsh penalties on employers seeking to enforce noncompetes that do not comply with the new rules. If the Noncompetition Agreement Act becomes law, employers will have to immediately alter their policies governing the use and enforcement of noncompetes.

THE PROPOSED NONCOMPETITION AGREEMENT ACT CODIFIES AND MODIFIES THE EXISTING RULES

Currently, no statute in Massachusetts sets forth the rules governing the enforcement of noncompetes. Rather, those rules have been created by judges. Under the judge-made existing rules, an employee noncompete is enforceable if (a) enforcement is necessary to protect a legitimate business interest, including the protection of trade secrets or the employer's goodwill; (b) the restrictions on competition are reasonable in duration, geography, and scope; and (c) the employee's promise not to compete is made in exchange for "consideration" or, in plainer terms, something of value, including employment. As explained below, the proposed Noncompetition Agreement Act (Act) codifies some of these rules and modifies others.

The Act codifies the existing rule that noncompetes are enforceable only if and to the extent that they protect legitimate business interests. The Act also codifies the existing rule that noncompetes are enforceable only if and to the extent that the restrictions on competition imposed in the noncompete are reasonable; however, it modifies the existing rule concerning the reasonableness of the duration of a noncompete in two ways. First, the existing rule is that the duration of a noncompete must be reasonable vis-à-vis the legitimate business interest protected by the noncompete. The Act retains that rule but also requires that judges consider whether the duration of the noncompete is reasonable "in relation to . . . the duration of actual employment." This means a judge could find that a one-year noncompete is enforceable as to the employee who worked for the employer for ten years but unenforceable as to the employee who worked for that same employer for only a year. Second, where the existing rule permits a judge to decide on a case-by-case basis whether a noncompete is reasonable in duration, the Act prohibits the enforcement of a restriction longer than one year.

The Act also codifies the current rule that a noncompete is enforceable only if the employee's promise not to compete is made in exchange for "consideration" from the employer; however, it modifies the rule that employment or, more specifically, continuing employment, is sufficient consideration. The Act prohibits the enforcement of an employee noncompete signed after the commencement of employment unless the employer provides the employee with "fair and reasonable consideration," in addition to continuing employment, in exchange for signing the noncompete. The proposed law does not define fair and reasonable consideration.

THE ACT CREATES NEW RULES

The proposed Noncompetition Agreement Act also creates three new rules, among others, governing the enforcement of noncompetes:

First, it permits a judge to refuse to enforce some or all of the restrictions in an otherwise enforceable noncompete in "extraordinary circumstances," "where otherwise necessary to prevent injustice or an unduly harsh result" or based on "equitable factors that would militate against enforcement." The Act defines none of these terms.

Second, it requires that, when deciding whether to enforce a noncompete, a judge must "take into account the economic circumstances of, and economic impact on, the restricted party." This new requirement is unprecedented in Massachusetts and any other state.

Third, it prohibits the enforcement of a noncompete signed in connection with the commencement of employment unless the employer "to the extent reasonably feasible," provides the prospective new employee with a copy of the noncompete and a notice that the noncompete is a condition of employment either (a) at least seven business days before the commencement of employment or (b) in a written employment offer, whichever is earlier.

The Act also provides that where the employer makes an employment offer orally, the employer must either inform the prospective employee at the time the offer is made that signing a noncompete is a condition of employment or provide the prospective employee with written notification of the noncompete requirement before the employee tenders her resignation from her then-current employer. Failure to comply with these new notice rules invalidates the noncompete.

THE ACT IMPOSES PENALTIES ON EMPLOYERS

The Act not only changes the rules governing the enforcement of noncompetes, but also imposes penalties on employers that sue to enforce noncompetes that do not comply with the new rules. Specifically, where an employer and its former employee are involved in litigation over the enforcement of a noncompete, the proposed Noncompetition Agreement Act requires that the employer pay the employee's legal fees in that litigation in three situations, even if those fees are originally being paid by someone other than the employee (for example, the employee's new employer).

First, the employer must reimburse the employee's legal fees if the court refuses to enforce a "material restriction" in a noncompete. That is, if a court decides not to enforce a noncompete or a significant portion of a noncompete, the employer must pay the employee's legal fees in the case. Second, the employer must reimburse the employee's legal fees, even where the employer ultimately prevails in the litigation, if the court "reforms a restriction in substantial respect." Thus, if a judge enforces a noncompete for a shorter period of time or in a more restricted geographical area than is provided for in the noncompete, the employer must still pay the employee's legal fees. Similarly, if a judge orders an employee not to work for her former employer's competitor but limits the ban to working in a specific field, as opposed to doing any work for a competitor, which is provided for in the employee's noncompete, the employer will have to pay the employee's legal fees. Third, the Act requires the employer to pay the employee's legal fees if a judge finds that the employer acted in "bad faith" in connection with the enforcement of the noncompete. Bad faith is not defined in the proposed Act.

Under the proposed Act, a judge does not need to wait until a lawsuit is concluded to order

that the employer pay the employee's fees. The judge can order the employer to pay the employee's legal fees at any time during the litigation, upon which the fees are "immediately due and payable to the employee."

The drafters of the proposed Act attempted to cushion the very harsh new rules requiring reimbursement of employee legal fees where a judge either refuses to enforce or reforms a portion of a noncompete by creating a "safe harbor." The Act provides that a court shall not order the employer to reimburse the employee's legal fees if the specific provision that the court either refuses to enforce or reforms is "presumptively reasonable" or if "the employer made objectively reasonable efforts to draft the rejected or reformed restriction so that it would be presumptively reasonable." Under the Act, the following provisions are presumptively reasonable: a six-month duration, a geographic reach limited to the area in which the employee provided services or had a "material presence or influence," and a restriction on activities that is limited to the services provided by the employee to her former employer during the two years prior to termination of employment.

While the Act creates new rules requiring employers to reimburse employee's legal fees in noncompete cases, it also severely limits the employer's ability to recover fees from an employee who breaches a noncompete, even where the noncompete contains a provision requiring that the employee pay the employer's legal fees incurred in connection with enforcing the agreement. The Act provides that a court may enforce such a provision only if the noncompete is presumptively reasonable in duration, geographic reach, and scope; the court enforces the agreement "without substantial modification;" and the employee acted in bad faith. Again, bad faith is not defined in the Act.

In sum, if adopted, the Noncompetition Agreement Act will dramatically alter the contours of the law governing the enforcement of noncompetes in Massachusetts. Employers should keep a close eye on the progress of the legislation and be prepared to make swift and sweeping changes in their policies if the legislation becomes law.

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