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What You Need to Know Now Changes to Massachusetts Noncompetition and Trade Secret Law

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Summary of Key Changes

- Applies to all noncompetition agreements entered into on or after October 1, 2018
- Generally limits post-employment noncompetition periods to a maximum duration of 12 months
 - 24 months permitted for breach of fiduciary duty or unlawful taking of property
- Absent agreement to the contrary, employers must pay employee 50% of the former employee's base salary during the period of restriction (so-called "garden leave clause")
- A noncompete is not permitted against former employee whose employment is terminated without cause by the company unless entered into in connection with leaving the company

Summary of Key Changes

New Procedural Requirements

- Noncompetes must be in writing and signed by employer and employee
- Must expressly state that the employee can consult an attorney before signing
- Must be provided to the employee either with the initial offer letter, or at least 10 business days before the start of employment, whichever is earlier (or in the case of a current employee at least 10 business days before the effective date)
 - Noncompetes should be part of formal offer letter
- Noncompetes entered into after commencement of employment (both other than in connection with employment termination) must be supported by “fair and reasonable consideration”
 - Continued employment will not qualify
 - Payment of annual bonus conditioned on noncompetition agreement?

Summary of Key Changes

What's Not New

- The Act codifies certain aspects of existing law
- Noncompetes can be “no broader than necessary to protect” the employer’s trade secrets, confidential information, or customer goodwill
- Cannot extend beyond “the geographic areas in which the employee ... provided services or had a material presence or influence [within the last 2 years of employment]”
- Accordingly, litigation strategy should not be dramatically affected

Summary of Key Changes

Who Can and Cannot be Covered by a Noncompete

- Noncompetes with:
 - Nonexempt employees under FLSA
 - Interns or other short term employment while enrolled in education
 - Employees who are terminated without cause
 - Employees under 18

... are per se unenforceable

- The Act applies to independent contractors

Summary of Key Changes

- The Act does not apply to other restrictive covenants including non-solicitation (employees and/or customers) and nondisclosure agreements
 - Expect greater emphasis on non-solicitation agreements
- The Act does not apply to noncompetes made in connection with the sale of a business

Interplay of Trade Secret Law and the Act

- MA has adopted the Uniform Trade Secrets Act as well
- UTSA protects trade secrets even if not in “continuous use”, which was the MA state standard
- Potential for inevitable disclosure argument in MA state courts can have as big of an impact on employee mobility
- Consider carefully whether the goal is to stop employee competition or simply to protect trade secrets

Important Issues

What is Cause?

- Critical to determine what qualifies as a “cause” for termination
- The Act does not define cause
- How much leeway will employers have to define “cause” in governing documents?
 - Consider including a cause definition that an employee acknowledges will apply to the noncompete
- It appears employers generally must pay for a noncompete covenant after termination for cause

Important Issues

Payment of Garden Leave Clause

- Leave before actual employment termination does not qualify as a garden leave
- Unclear how courts will interpret what is “other mutually agreed upon consideration” that can be provided in lieu of garden leave to support a noncompete
 - Amount of payment
 - Timing of payment (lump sum, installments)
 - Non-cash compensation
- Interplay with blue pencil provisions?

Important Issues

Extending the Noncompete Period

- Act permits extension for a breach of fiduciary duty or unlawful taking of property to two years without further payment
 - Ample breach of fiduciary duty precedent under Massachusetts law
- Will tolling provisions be respected?
 - Must extension run from termination or from later discovery?

Important Issues

Available Exceptions

- “Noncompetition agreements made in connection with the cessation of or separation from employment”
 - Should employers attach a form of a noncompetition agreement to an offer letter as consideration for severance to invoke the exception?
- Non-solicitation covenant “not to solicit or transact business with customers, clients or vendors” - how far does “clients” stretch?
- How will non-solicitation exception work in practice with clients that are not publicly known?

Important Issues

Restrictions - Geographic Locations

- Reasonability standard assumes a geographic area is reasonable if during the prior 2 years of employment the employee had a “material presence or influence.”
 - How is “material presence or influence defined?” Salespeople with national presence, etc.

Important Issues

Choice of Law and Venue

- All actions enforcing or challenging a noncompete agreement must be brought in the county in which the employee resides or, if the parties mutually consent, in Suffolk County “superior court or the business litigation session of the superior court.”
- MA law must be applied to employees who reside in or are employed in MA at time of termination
 - Risk for employers in transferring employees to MA
 - Extraterritorial question for MA residents working in other states to be addressed by courts
- Prohibition against parties commencing actions in or removing them to federal courts is of questionable validity

Important Issues

Effect of MA law on ERISA plans

- Many types of compensation and benefit plans have forfeiture provisions that apply if there is a noncompete breach
 - Examples: supplemental pension, deferred compensation and certain severance plans
 - Stock options are not subject to ERISA
- Would ERISA pre-empt MA law in enforcing a forfeiture for competition clause?
 - Will employers backload more competition into ERISA plans for senior executives?

Important Issues

Effect of MA law on 280G Golden Parachutes

- Noncompetes often are used by employers to offset parachute values – enforceable noncompetes can be treated as “reasonable compensation”
- What if a noncompete is not entered into termination of employment by the company (e.g. supporting vesting of a stock option)?
- How will “good reason” termination be treated?
- Auditors may require opinion of counsel as to interpretation of Massachusetts law for tax position

Important Issues

Sale of Business Provision

- Law exempts sellers where “the party restricted by the noncompetition agreement is a significant owner of, or member or partner in, the business entity who will receive significant consideration or benefit from the sale or disposal.”
 - Are option holders covered as “significant owners” – at what level?
 - How much is “significant consideration” – how can it be established in corporate transactions?

October 1st is Approaching

- Will an agreement amended after October 1st be considered a new agreement?
- Should employers try to get stand-alone noncompetition agreements in place with existing employees before October 1st?
- How will litigation involving agreements entered into before October 1st be affected?

Next Steps

- Consider enhancing existing non-solicitation and nondisclosure agreement provisions
- Consider a tiered approach tied to seniority and/or responsibilities

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