WASHINGTON'S WORKFORCE MOBILITY LAW GOES LIVE: A SEVEN-QUESTION ASSESSMENT FOR STARTUPS AND GROWTH COMPANIES

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INTRODUCTION: RCW 49.62 IS IN EFFECT

For startups and growth companies that delayed getting a grip on the state of Washington's new law restricting the use of noncompetition covenants in employment-related agreements, the time to act is now, as the new law took effect on January 1, 2020. In its findings in support of the law, the legislature has taken the position that "workforce mobility is important to economic growth and development" and "agreements limiting competition in hiring may be contracts of adhesion that may be unreasonable." Accordingly, for the purposes of this Alert, we refer to Washington's new law as the "*Workforce Mobility Law*."

Codified under RCW 49.62, the Workforce Mobility Law casts a broad net and prohibits any covenant (whether contained in an offer letter, employment agreement, stock option agreement, incentive pay agreement, or other document or policy) that restricts an employee's ability to perform work for others unless the covenant falls within certain narrow exceptions. These restrictions apply to all such covenants (referred to herein as "noncompetes"), regardless of the date of the agreement, and cover both employees and independent contractors working in Washington.

The Workforce Mobility Law renders noncompetes void and unenforceable unless they meet certain procedural and substantive requirements, including annual earnings thresholds of $100,000 for employees and $250,000 for independent contractors, as well as timely disclosure requirements and a default maximum duration of 18 months. The potential costs for noncompliance with the law are real, including responsibility for actual damages, statutory penalties, attorney fees, and costs incurred by an employee.

As it is written, the Workforce Mobility Law leaves many questions unanswered and creates the potential for very broad limitations on certain types of contractual restrictions on the activities of employees and independent contractors. Accordingly, employers who rely on noncompetes or any types of restrictions to protect their business interests should consult with legal counsel to ensure their noncompetes are precisely drafted.

AN ASSESSMENT: SEVEN QUESTIONS FOR STARTUPS AND GROWTH COMPANIES

To assess their readiness for the Workforce Mobility Law (including related hiring practices), here are seven questions startups and growth companies with Washington-based employees or independent contractors

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(collectively referred to below as "service providers") should ask about their current and contemplated noncompetes:

1. *Does the noncompete meet the relevant compensation threshold?*
2. *How long is the noncompete period?*
3. *Does the noncompete provide for adjudication in Washington?*
4. *For employee noncompetes, was the agreement signed before the employee accepted the offer of employment?*
5. *What are the potential risks and liabilities for noncompliance with the new law?*
6. *For noncompetes signed after January 1, 2020, will the noncompete have a forward-looking enforceability provision?*
7. *Is a noncompete necessary to achieve the desired business objective?*

This Alert considers these questions and offers a few practice tips for startups and growth companies.

QUESTION 1: DOES THE NONCOMPETE MEET THE RELEVANT COMPENSATION THRESHOLD?

Under the Workplace Mobility Law, noncompetes are void and unenforceable against an employee unless the employee's "earnings" exceed $100,000 when annualized. For an independent contractor, the threshold is $250,000 per year.[1] Effective January 1 each year, these compensation threshold amounts will be adjusted for inflation by Washington's Department of Labor and Industries.

> Practice Tips for Startups and Growth Companies:
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> - Keeping track of the compensation threshold is imperative.
>   - A noncompete that meets the relevant threshold today will be unenforceable next year if it does not meet the adjusted threshold.
> - “Earnings” likely does not include equity compensation.
>   - “Earnings” are tied to compensation reported on W-2 forms for employees or 1099-MISC forms for independent contractors, and equity grants are not routinely reflected there. Accordingly, equity compensation like stock option grants are not likely to be considered earnings.
> - “Earnings” do not include certain amounts, such as pre-tax amounts employees contribute to 401k plans or health savings accounts.
> - The compensation threshold is annualized for employees, but not for independent contractors.
>   - It will be more difficult for boot-strapped startups to rely on noncompetes for independent

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> contractors, because the compensation threshold is higher and likely must be satisfied in total — on a yearly basis — before the noncompete can be enforced.
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> - Given the cost, growth companies may wish to bring on key service providers as employees rather than independent contractors if noncompetes are important to the business. Doing so would also remove the risk of potential misclassification of employees as independent contractors.

Startups and growth companies should keep in mind that, if a noncompete does not meet the relevant compensation threshold, it cannot be validly enforced against the service provider in question.

QUESTION 2: HOW LONG IS THE NONCOMPETE PERIOD?

The Workplace Mobility Law provides that any noncompetes with a duration exceeding 18 months is presumptively unreasonable and unenforceable. An employer may rebut this presumption only by proving by "clear and convincing evidence" (a very high standard of proof) that a longer period is necessary to protect the employer's business or goodwill.

If an employee has an existing noncompete entered into prior to January 1, 2020, that exceeds the 18-month restriction, the employer could: (1) modify the noncompete or enter into a new noncompete, or (2) elect not to enforce the noncompete. Each strategy has tradeoffs.

- A modification of a current employee's existing noncompete agreement, or the replacement of that agreement with a new noncompete, would likely require independent consideration, as the Workplace Mobility Law provides that noncompetes entered into after the commencement of employment must be supported by "independent consideration." While that term is not defined in the new law, existing common law indicates that any additional consideration that an employee would not have otherwise received (such as a pay increase, a bonus, a promotion, or additional training) may be sufficient.
- If an employer wishes to enforce a noncompete with a restrictive period in excess of 18 months, seeking legal counsel prior to enforcement is recommended, as it is difficult to predict how a court will interpret and apply the Workplace Mobility Law in such a scenario. Even if the noncompete were to be enforced for a period of up to 18 months, the employer may be held liable for a statutory penalty of $5,000 and the employee's attorneys' fees.

Startups and growth companies should proceed cautiously when amending existing noncompetes or entering into new noncompetes. A new noncompete executed by a current employee as a condition of continued employment will not be supported by independent consideration. Similarly, relying on a nominal bonus or *de minimis* side benefit as consideration for a new noncompete or a noncompete amendment may be risky, given the potential costs associated with any legal dispute involving a noncompete (more on this in Question 5 below), and such consideration may not provide a sufficient incentive for an employee to sign a new covenant.

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QUESTION 3: DOES THE NONCOMPETE PROVIDE FOR ADJUDICATION IN WASHINGTON?

The Workplace Mobility Law requires that any dispute over a noncompete involving Washington-based service provider be resolved in the state of Washington. Contract provisions that require adjudication outside of Washington are void and unenforceable, as are provisions that deprive service providers of the Workplace Mobility Law's protections or benefits. Going forward, employers should confirm that the venue and choice of law provisions in their noncompetes provide for litigation or arbitration (1) inside the state, and (2) under Washington law.

QUESTION 4: FOR EMPLOYEE NONCOMPETES, WAS THE AGREEMENT SIGNED BEFORE THE EMPLOYEE ACCEPTED THE OFFER OF EMPLOYMENT?

The Workplace Mobility Law codifies existing case law that in effect required employers to disclose the terms of any noncompete at or prior to the commencement of the employee's employment. As a practical matter, this means that noncompetes must be part of the bargain for employment — *and disclosed in writing at or prior to the time of the employee's acceptance of the offer of employment*. In the past, employers have sometimes requested that employees sign all employment-related agreements, including noncompetes, on an employee's first day of work. That practice is no longer advisable. Noncompetes disclosed and signed on an employee's first day of work may be unenforceable, absent independent consideration.

> Practice Tips for Startups and Growth Companies:
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> - Timing is everything.
>   - A noncompete disclosed on Day 1 of employment is too late.
>   - If a noncompete was not disclosed in writing at or before the time of the employee's acceptance of an offer employment, additional independent consideration will be required to have an enforceable noncompete.
> - Use written offer letters for extending offers of employment, and attach all the relevant Day 1 agreements.
>   - Although many startups and growth companies do not rely on formal employment agreements, they should adopt a consistent practice of drafting written offer letters, with the relevant noncompete provisions embedded alongside salary and other benefit information or separately provided in stand-alone agreements (see below).
>   - If an employee will sign a noncompete in a separate agreement (e.g., an agreement form addressing such topics as confidentiality and intellectual property assignment), that agreement should be attached to the offer letter and its execution should be an express condition of the acceptance of the offer of employment.
> - Notice is everything, too.
>   - A noncompete cloaked in the fine print is likely insufficient to create a valid and enforceable

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noncompete obligation.

- A best practice is to call out for employees in a separate notice section that the offer letter or other agreement contains a noncompete provision.

Startups and growth companies should re-evaluate their hiring and on-boarding practices, especially those that do not use written employment agreements or offer letters, to ensure any noncompetes are in writing and are otherwise in compliance with the Workplace Mobility Law.

QUESTION 5: WHAT ARE THE POTENTIAL RISKS AND LIABILITIES FOR NONCOMPLIANCE WITH THE NEW LAW?

The Workplace Mobility Law provides for both a private and public right of action for violations of the statute. A person aggrieved by a noncompete to which they are a party may pursue relief for noncompliant noncompetes, as may the attorney general of the state of Washington on behalf of any such aggrieved person or persons.

Under the law, if an employer attempts to enforce a noncompete that is determined by a court or arbitrator to violate the law, to be only partially enforceable, or to require any modification or revision (regardless of how minor) to make it legally complaint, the employer must pay the greater of the employee's actual damages or a penalty of $5,000, as well as the employee's reasonable attorneys' fees and costs incurred in the proceeding. Employees can also bring actions challenging the enforceability of noncompetes entered into after January 1, 2020, with the same remedies available to the employee. A cause of action may not be brought, however, regarding a noncompete signed prior to January 1, 2020, if the noncompete is not being enforced.

Practice Tips for Startups and Growth Companies:

- For noncompetes signed before January 1, 2020:
  - A noncompliant noncompete provision does not in itself create a cause of action unless the employer attempts to enforce it.
  - Actions for declaratory relief are not permitted.
  - For employers, the risk associated with enforcing a noncompliant noncompete (e.g., with a 24-month noncompete period) is automatic statutory damages and legal fees and costs.
- For noncompetes signed after January 1, 2020:
  - A noncompliant noncompete provision creates a cause of action now — even if the employer is not seeking to enforce the noncompete.
  - Actions for declaratory relief are permitted.
  - For employers, the risk of a noncompliant noncompete is that a service provider may sue for

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declaratory relief even when the noncompliant provision is not being enforced.

- Noncompliance with either the substantive or procedural requirements of the law (e.g., duration, venue, choice of law, or disclosure provisions) gives service providers recourse to challenge the noncompete, potentially on a cost-free basis.

Startups and growth companies should be very confident that any new noncompetes entered into after January 1, 2020, comply with the Workplace Mobility Law, including amendments to existing noncompetes signed before January 1, 2020. The Workplace Mobility Law encourages service providers to defend their statutory prerogatives through litigation or arbitration to the full extent of the law, even in noncontentious circumstances. A drafting error may not only render the noncompete unenforceable but also expose the company to mandatory damages for noncompliance.

QUESTION 6: FOR NONCOMPETES SIGNED AFTER JANUARY 1, 2020, WILL THE NONCOMPETE HAVE A FORWARD-LOOKING ENFORCEABILITY PROVISION?

The Workplace Mobility Law provides that any noncompete that purports to be enforceable in the future due to a subsequent increase in earnings (i.e., when earnings reach the threshold set by law) must be specifically disclosed in writing to an employee no later than the time of the employee's acceptance of the offer of employment. For noncompetes entered into before January 1, 2020, with employees who did not meet the earnings threshold at the time of acceptance of the offer employment, but who subsequently reach that threshold, the enforceability of such noncompetes remains uncertain under the new law until such time as a court addresses the issue.

Startups and growth companies should consider adding forward-looking enforceability provisions in noncompetes that will be entered into after January 1, 2020. These provisions should operate to ensure that the procedural requirements for an enforceable noncompete are in place, if and when the earnings threshold is satisfied (assuming all other procedural and substantive requirements are met).

QUESTION 7: IS A NONCOMPETE NECESSARY TO ACHIEVE THE DESIRED BUSINESS OBJECTIVE?

After considering Questions 1–6 in this assessment, the final question employers should ask is whether they really need a noncompete to achieve their business objective. Is it worth it?
Although the Workplace Mobility Law restricts the use of noncompetes (which were already subject to judicial scrutiny for reasonableness as a matter of equity), the statute leaves open many other tools that employers might use to achieve similar ends.

Practice Tips for Startups and Growth Companies:

- Under the law, the definition of “noncompetition covenant” expressly excludes the following types of agreements and convents (which still must be appropriately tailored to avoid potential conflicts

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with the law):

- Nonsolicitation agreements;
- Confidentiality agreements;
- Covenants prohibiting use or disclosure of trade secrets or inventions;
- Covenants entered into by a person purchasing or selling the goodwill of a business or otherwise acquiring or disposing of an ownership interest; and
- Covenants entered into by a franchisee when the franchise sale complies with RCW 19.100.020(1).

- Accordingly, employers retain significant latitude to seek some of the protections that can be provided by a noncompete through other agreements or covenants tailored to address specific concerns (e.g., protection of trade secrets or the solicitation of current customers).

Ultimately, startups and growth companies may come to the conclusion that noncompetes are not worth the increased administrative costs and litigation risks created by the Workforce Mobility Law. Those same companies may find, on reflection, that a well-crafted alternative agreement or covenant may suit their business needs just as well, if not better.

CONCLUSION: DIFFICULT, BUT NOT IMPOSSIBLE

Overall, the Workforce Mobility Law further limits the ability of employers to use and rely upon noncompetes in the state of Washington. With careful planning, however, it is still possible to have enforceable noncompetes with service providers who meet the earnings thresholds of the new law. Startups and growth companies that have relied on noncompetes in the past as matter of routine, however, should re-assess that practice. Circumspection is now required due to the costs and risks associated with the use and attempted enforcement of noncompetes. Precision drafting is essential. For circumstances where companies believe a noncompete is necessary to advance their business interests, consultation with legal counsel is essential.

Startups and growth companies should be aware that the Workforce Mobility Law will be strictly construed against any limitations placed on employees or independent contractors. In addition, there are other traps for the unwary in the Workforce Mobility Law, including special provisions for laid-off employees (RCW 49.62.020(1)(c)), franchisors (RCW 49.62.060), and moonlighting employees (RCW 49.62.070).

K&L Gates LLP is here to answer these and other questions that startups and growth companies operating in Washington may have related to the Workforce Mobility Law, as we can assist in the drafting and revision of appropriate noncompete agreements based on an individual employer's business, workforce, and state(s) of operation.

NOTES

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[1] Under RCW 49.62.010, "*Earnings*" for employees means "the compensation reflected on box one of the employee's United States internal revenue service form W-2 that is paid to an employee over the prior year, or portion thereof for which the employee was employed, annualized and calculated as of the earlier of the date enforcement of the noncompetition covenant is sought or the date of separation from employment." Under RCW 49.62.010, "*Earnings*" for independent contractors means "payments reported on internal revenue service form 1099-MISC."

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