

Federal and state legislative and regulatory developments in restrictive covenant law

By Elizabeth J. Casey, Esq., and John P. Barry, Esq., Weil, Gotshal & Manges LLP*

APRIL 12, 2023

In 2022, there were significant developments in the restrictive covenant space, and the beginning of 2023 has already been no different. In 2022, many state and local governments continued to impose limits on the use of restrictive covenants, specifically noncompetition provisions.

To ring in the year 2023, at the federal level, after President Biden previously signed a July 2021 executive order¹ that encouraged the Federal Trade Commission (FTC) to “curtail the unfair use of non-compete clauses,” the FTC proposed a new rule² which, if promulgated, would prohibit non-compete agreements between employers and employees, as well as related agreements that function as “de facto” non-compete clauses, such as overbroad non-solicitation and non-disclosure provisions.

The FTC, citing a preliminary finding that noncompetition agreements constitute an unfair method of competition and therefore violate Section 5 of the Federal Trade Commission Act, is currently seeking public comment on the proposed rule.

The proposed rule would apply to independent contractors, employees and unpaid interns and would make it illegal for an employer to enter into, attempt to enter into, or to maintain a noncompete agreement with a worker or to represent to a worker that they are subject to such a provision. It would also place some fairly stringent limits on the use of non-competes in the sale of business context.

The FTC, citing a preliminary finding that noncompetition agreements constitute an unfair method of competition and therefore violate Section 5 of the Federal Trade Commission Act, is currently seeking public comment on the proposed rule. Please read our Weil Alert³ for further information and analysis on the proposed rule.

On the state level, several restrictive covenant laws that were enacted in 2021⁴ took effect in 2022, including:

- The **District of Columbia’s** revised non-compete law, the Non-Compete Clarification Amendment Act of 2022⁵ went into effect on October 1, 2022. The amended law makes it unlawful to enter into non-compete agreements (outside the sale of business context) with employees who do not meet a certain compensation threshold (currently, for most employees, \$150,000), which threshold will increase annually beginning in 2024. Employers must also provide job applicants and employees with statutory notice and a copy of the agreement 14 days before execution or commencing employment. Agreements that violate the law are void and unenforceable, and employers may be subject to civil and administrative penalties. D.C.’s law also requires employers to provide timely notice to all employees (not just highly compensated individuals) of workplace policies that fall within one of the exceptions to the definition of a noncompete provision, *i.e.*, non-disclosure, anti-moonlighting, etc. Please refer to our prior *Employer Update*⁶ article for further discussion regarding D.C.’s law.
- **Colorado’s** restrictive covenant law, Colorado House Bill 22-1317,⁷ which took effect on August 10, 2022, forbids non-competition and customer non-solicitation agreements with employees who are not “highly compensated” if the agreements are not signed in connection with the sale of a business. An employee must meet the earning threshold both at the time the covenant is entered into, and at the time the employer seeks to enforce the covenant. The law also requires employers to notify job applicants of the covenants (this needs to be done in a separate document, so yet another administrative burden to keep in mind) and provide a copy of the agreement 14 days before (i) the applicant accepts the offer of employment, or (ii) for current employees, the earlier of the effective date of the agreement or the date the consideration for the agreement is provided. Significantly, the law mandates that Colorado law govern all such agreements with workers who primarily reside or work in Colorado at the time of the termination of their employment. Failure to comply

with the law's requirements will void the restrictive covenants, and subject employers to actual damages as well civil and potentially criminal penalties.

- **Illinois'** amendments to Illinois' Freedom to Work Act⁸ went into effect on January 1, 2022. The amendments impose a host of new conditions for restrictive covenant agreements entered into on or after January 1, 2022, including (1) requiring a 14-day consideration period for a non-compete, (2) mandating that employees be affirmatively advised to consult with an attorney prior to signing a non-compete, (3) prohibiting employers from entering into non-competes with employees earning less than \$75,000 annually or non-solicits with employees earning less than \$45,000 annually, with these thresholds increasing incrementally every five years until 2037.
- **Oregon's** amendments to Oregon's non-compete statute⁹ also went into effect on January 1, 2022. Under the amended law, non-competition agreements entered into on or after January 1, 2022 cannot exceed 12 months in duration post-employment. The amended law also prohibits employers from entering into non-competes with employees earning less than \$100,533 in gross salary and commissions annually (adjusted yearly for inflation) or non-exempt workers unless the employer agrees in writing to pay the employee at least the greater of (i) 50% of the employee's gross salary and commissions or (ii) 50% of \$100,533 (adjusted yearly for inflation).

As we discussed in a prior *Employer Update*¹⁰ article, other states also have introduced legislation to curtail the use of restrictive covenants that are making their way through the legislative process, including New Jersey's Assembly Bill 3715.¹¹

Among other restrictions, the proposed New Jersey bill would ban non-competes for low wage workers and cap the length of all post-employment restrictive covenants to 12 months. Perhaps most notably, the bill would require an employer to pay an employee 100% of their compensation during the restricted period – essentially mandating garden leave.

Given these significant developments at the federal and state level, we recommend that employers audit their existing restrictive covenants agreements to ensure that they comply with the many state laws requirements (particularly low wage thresholds, temporal scope and notice) and are properly tied to the protection of legitimate company interests (i.e., confidential information, trade secrets and customer goodwill).

Notes

¹ <https://bit.ly/34iLiPL>

² <https://bit.ly/3lj0uha>

³ <https://bit.ly/40XKrMD>

⁴ <https://bit.ly/43soCpZ>

⁵ <https://bit.ly/3UptDv>

⁶ <https://bit.ly/3KwejsB>

⁷ <https://bit.ly/3zQ2xE>

⁸ <http://bit.ly/3GE8DeL>

⁹ <http://bit.ly/3MCTQor>

¹⁰ <https://bit.ly/43soCpZ>

¹¹ <http://bit.ly/41h2KMC>

About the authors



Elizabeth J. Casey (L) is an associate with **Weil, Gotshal & Manges LLP**. She is a member of the firm's employment litigation practice group based in New York and Houston. She can be reached at elizabeth.casey@weil.com. **John P. Barry (R)** is a partner and head of the firm's employment litigation practice group. He is based in New York and can be reached at john.barry@weil.com. This article was originally published March 15, 2023, on the firm's website. Republished with permission.

This article was published on Westlaw Today on April 12, 2023.

* © 2023 Elizabeth J. Casey, Esq., and John P. Barry, Esq., Weil, Gotshal & Manges LLP

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional. For subscription information, please visit legalsolutions.thomsonreuters.com.