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Trade Secrets & Competitive Hiring

SEPTEMBER 12, 2022 • NO. 1

New D.C. Noncompete Law to (Finally) Take Effect October 1

The Ban on Non-Compete Agreements Amendment Act of 2020 (the "Act") passed by the D.C. Council over the summer will take effect on October 1, 2022, imposing new substantive and procedural restrictions on D.C. employers' use of noncompetes, new compensation thresholds below which such noncompetes are now banned, and creating new administrative and civil enforcement measures, including administrative penalties for noncompliance.

THE NEW LAW IN A NUTSHELL

The Act defines "noncompete provision" as "a provision in a written agreement or a workplace policy that prohibits an employee from performing work for another for pay or from operating the employee's own business." Consequently, the law covers both agreements containing noncompetes and workplace policies restricting employee's competitive or outside activities, subject to several exceptions summarized below.

Most notably, the Act imposes two new income thresholds for "noncompete provisions" with "highly compensated employees"—those who earn at least $150,000—and "medical specialists"—licensed physicians earning at least $250,000. Both thresholds are subject to adjustments in accordance with increases in the Consumer Price Index beginning in 2024, and any "noncompete provisions" with employees below those levels are effectively banned by the Act.

The Act clarifies that wages, salary, bonuses or other cash incentives, commissions, overtime premiums, vested stock and restricted stock units, and other payments provided on a regular or irregular basis may all be included in determining who qualifies as a "highly compensated employee." The Act excludes the value of noncash fringe benefits, but because it does not define "fringe benefits," there is uncertainty as to what noncash benefits may constitute "other payments provided on a regular or irregular basis."

The Act imposes limitations on the scope of noncompetes with highly compensated employees, including a requirement that the noncompete specify the "services, roles, industry or competing entities" that are restricted and requires that the noncompete specify the geographical limitations of the work restriction. Noncompetes with "medical specialists" are now capped at a period of 730 days from the date the medical specialist "separates from employment," and noncompetes with other "highly

compensated employees" are capped at a period of 365 days from the date the employee "separates from employment." In instances where such an employee remains on an employer's payroll but is no longer performing services, including during periods of advance notice of termination or garden leave, the meaning of "separates from employment" might be subject to interpretation.

In addition to those substantive limitations, the new law imposes stringent procedural notice requirements for employers. Employers must provide prospective employees with a written copy of any actual noncompete provision at least 14 days prior to commencement of employment, or, in the case of existing employees, at least 14 days before the employee must execute or agree to any such noncompete provision. Employers must also provide impacted employees with a specifically worded statutory notice at the time a noncompete is proposed. Similar notice requirements exist for other types of provisions excluded from the definition of "noncompete provisions," as noted below.

Finally, the Act also prohibits employers from retaliating against an employee who refuses to sign a noncompete, who fails to comply with a noncompete that violates the law, or who asks or complains about a workplace policy or noncompete agreement that the employee reasonably believes violates the law.

NOTABLE EXCEPTIONS TO ACT'S RESTRICTIONS ON "NONCOMPETE PROVISIONS"

The Act does, however, contain multiple exceptions that allow for the enforcement of other common restrictions.

Among them, the Act permits employers to prohibit employees from working for someone else while they are employed by the employer if the employer reasonably believes that doing so will result in disclosure of the employer's confidential information, "conflict with the employer's, industry's, or profession's established rules regarding conflicts of interest," or impair the employer's ability to comply with D.C. or federal laws or regulations or the terms of any contract. This exception is welcome news to employers given that the original version of the Act passed in December 2020 banned *all* noncompete restrictions that applied during the term of an employee's employment, which likely would have encompassed moonlighting or conflict of interest policies commonly relied upon by employers.

The law also does not prevent employers from entering into agreements that preclude the use or disclosure of confidential information or that prevent former employees from soliciting customers or the employer's employees.

In addition, the law excludes from the noncompete ban "an otherwise lawful provision…that provides a long-term incentive." The Act defines "long-term incentive" to include "bonuses, equity compensation, stock options, restricted and unrestricted stock shares or units, performance stock shares or units, phantom stock shares, stock appreciation rights and other performance driven incentives for individual or corporate achievements typically earned over more than one year." This exception is significant, as it appears to open the door to the use of long-term incentive programs and plans as a vehicle to impose restrictions on the competitive activities of employees during and after employment, including against those who are not "highly compensated employees" (or "medical specialists") as well as restrictions that exceed the subject matter and durational limits imposed elsewhere in the Act.

Also excepted from the Act's restrictions are noncompetes "[c]ontained within or executed contemporaneously with an agreement between the seller of a business and one or more buyers of that business wherein the seller agrees not to compete with the buyer's business." The law does not define the term "seller" and it is, therefore, uncertain whether employees with small ownership interests in a business that is being sold might fit within the exception and whether such an "agreement between the seller…and one or more buyers" is limited to the quintessential sale of a business from one owner or set of owners to a third party or whether it could potentially also include agreements for sale in other contexts such as in shareholders agreements or LLC operating agreements that may provide for noncompete restrictions for current and former shareholders or members in connection with their acquisition of ownership or the buy-back or redemption of any ownership interest.

Importantly, employers are required to disclose all such excepted workplace policies and obligations to employees within 30 days of the law's effective date of October 1, 2022, within 30 days of the commencement of employment, and "[a]ny time such policy changes."

WHICH EMPLOYERS AND EMPLOYEES DOES THE NEW LAW COVER?

The Act defines an "employer" as an "individual, partnership, general contractor, subcontractor, association, corporation, or business trust operating in the District, or any person or group of persons acting directly or indirectly in the interest of an employer operating in the District in relation to an employee, including a prospective employer, but does not mean the District government or the United States government." On its face, this leaves out a limited liability company, unless it happens to be a general contractor or a subcontractor.

The Act defines "employee" as "(i) an individual who performs work for pay in the District on behalf of an employer; or (ii) an individual to whom the employer has made an offer of employment and whom an employer reasonably anticipates will perform work for pay on behalf of the employer in the District." The Act also expressly excludes from the definition of "employee" an individual employed as a "casual babysitter, in or about the residence of the employer"—not the typical candidate for a noncompete—and a partner in a partnership.

The statutory phrase "work for pay…on behalf of an employer" introduces a fair measure of ambiguity within the definition of "employee," leaving open the question of whether independent contractors might also be covered by the law.

Additionally, assuming an individual is an employee working for pay on behalf of an employer, they will only receive the new law's protection if the individual spends more than 50 percent of work time working for the employer in D.C., or if the individual's employment is based in D.C. and the individual spends a substantial amount of work time working for the employer in D.C. and not more than 50 percent of work time working for the employer in another jurisdiction. Although not explicit, this appears to be based upon physical presence, which means that someone employed by a company based outside of D.C., but working for that company remotely from their residence in D.C., will likely be protected by the new law.

WHAT ARE THE CONSEQUENCES OF VIOLATING THE ACT?

Employers should take note that the Act provides for new administrative authority and enforcement mechanisms, including an obligation to maintain records pertaining to compliance with the Act and to disclose such records in response to a demand from the Mayor or from an administrative agency.

The Act provides that any "noncompete provisions" that violate the new statutory requirements—including both the compensation thresholds and scope requirements and the notice obligations—are not only unenforceable but also subject to the Mayor's imposition of monetary penalties on the employer that would be assessed on each violation following a hearing with the employer. The per-violation penalty is no less than $350 and no more than $1,000, but there is minimum net-penalty of $1,000. The Act also sets minimum financial remedies against employers in a variety of contexts, including (i) in any administrative investigation or in any civil action brought against the employer by an employee challenging a violation of the Act; (ii) in any action based upon an employer's attempt to enforce a violative noncompete or based upon an employer's retaliation against an employee in violation of the Act; and (iii) in any action based on a violation of the notice and disclosure obligations under the Act. In the case of employers who are repeat offenders, some of those minimum financial remedies increase to as high as $3,000 for each impacted employee. The Act expressly provides that those minimum financial remedies are cumulative and to be assessed in addition to any of the administrative penalties.

WHAT SHOULD EMPLOYERS CONSIDER DOING TO PREPARE AND COMPLY?

The Act is applicable to noncompete agreements executed on or after October 1, 2022, but appears to preclude employers from mandating compliance with workplace policies that are deemed "noncompete provisions" under

the Act on or after October 1, 2022, even if those policies were already in effect before then. In other words, existing noncompete agreements, but likely not existing workplace policies, are grandfathered under the Act.

D.C. employers who are interested in using noncompetes should, therefore, consider the following:

1. Identify which employees are within the scope of the law based upon where they work.

2. Identify which employees are "highly compensated employees."

3. Consider whether alternative forms of restrictions not covered by the Act would offer adequate protection, including confidentiality and non-solicitation restrictions.

4. Consider whether restrictions should be added to long-term incentive agreements or added to governance documents with owners, including employee owners.

5. Consider whether to enter into agreements containing noncompetes before the Act takes effect, including with categories of employees that will later be encompassed by the Act or with employees whose agreements may be expiring.

6. Modify restrictive covenant agreement forms to be used with "highly compensated employees" to address the subject matter and durational restrictions in the Act.

7. Modify workplace policies to comply with the Act, and consider adopting conflict of interest policies or terms of employment that address what sort of outside work an employee may engage in to take advantage of the Act's authorization of such policies for employees at all compensation levels.

8. Implement practices to ensure compliance with the Act's notice and disclosure obligations, including with respect to providing prospective employees and existing employees with 14-days' advanced notice of any "noncompete provision" they must sign or comply with as a condition of employment or as a condition of any new role or benefit, and educate human resources and talent and acquisition personnel, hiring managers, and third-party recruiters of those practices to ensure compliance.

If you have any questions about the impact of the Act on your company's contracting and hiring practices and reliance upon noncompetes with D.C. employees, please reach out to Dan Morgan or Kevin Passerini, or another member of the Trade Secrets & Competitive Hiring team at Blank Rome LLP for guidance and support.

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