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Benefits & Compensation University

Developments & Key Issues in US Employment Law Related to Executive Compensation

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Today's Presenters

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Marcia Goodman primarily represents global employers on a wide range of US and cross-border employment law matters. In addition, she co-leads the firm's Japan Client Initiative, a program aimed at strengthening and expanding Mayer Brown's ability to serve Japanese clients. She defends employers in federal class claims of race, age, sex, disability, national origin discrimination under EEO laws (e.g., reductions in force, promotions, sexual harassment, discriminatory terms, and conditions of employment) and in pattern and practice discrimination claims by the EEOC, as well as defending employee benefit plans and employers in ERISA class actions.

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Andrew Rosenman is Co-Leader of Mayer Brown's Employment Litigation & Counseling Practice. His practice particularly emphasizes labor and employment litigation and counseling on behalf of employers. In the course of his litigation and employment law practice, Andrew represents clients in a broad variety of actions, including trials, class and collective actions, appellate cases, individual claims, administrative proceedings, mediations and more.

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Ruth Zadikany is a partner in the Los Angeles office of Mayer Brown's Litigation & Dispute Resolution practice and Co-Leader of Mayer Brown's US Employment Litigation and Counseling Group. She is an experienced litigator whose practice focuses on representing clients in a broad range of labor and employment-related matters, as well as other high-stakes complex litigation. Ruth has been recognized as a leading employment lawyer by leading publications, including *Chambers USA* (2021), *Legal 500 US* (2021) and *Benchmark Litigation* (2021).

Agenda

I. Non-Competes: Recent Developments under Federal Law
   A. President Biden's Executive Order
   B. Proposed Federal Legislation
II. Non-Competes: The Current Non-Compete Legal Landscape Overview 2021-2022
   A. Trends in State Law Restrictions – Recent Developments Across the US
   B. An Example—Illinois Freedom to Work Act (effective January 1, 2022)
III. The Forfeiture for Competition Doctrine
IV. Arbitration
V. Considerations When Drafting Restrictive Covenants
VI. Lessons Learned from Litigation

President Biden's July 9, 2021 Executive Order

- Section 5(g): "[T]he FTC is encouraged to consider working with the rest of the Commission to exercise the FTC's statutory rulemaking authority . . . to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."
  - What constitutes "unfair" use of non-compete clauses"?
  - What is the scope of "other clauses or agreements"?
  - Do all non-compete covenants "unfairly limit worker mobility"?
- Section 4 establishes a White House Competition Council to promote and advance efforts to address unfair competition in the economy

President Biden's July 9, 2021 Executive Order (cont'd)

- White House Fact Sheet: The Executive Order "includes 72 initiatives by more than a dozen federal agencies to promptly tackle some of the most pressing competition problems across our economy."
  - "Make it easier to change jobs and help raise wages by banning or limiting non-compete agreements…"
  - "Encourages the FTC to ban or limit non-compete agreements"
- Stay tuned for potential further guidance/action from the FTC

Proposed Federal Legislation

- At the federal level, two bills that have been proposed in Congress to eliminate or significantly restrict non-compete agreements.
  - The Federal Freedom to Compete Act, initially introduced in the Senate in January of 2019 (S. 124), proposed to amend the Fair Labor Standards Act (FLSA) to ban non-competes for most non-exempt workers. The bill was reintroduced in the Senate in July 2021 (S. 2375).
  - The Workforce Mobility Act, first introduced in the Senate in 2019 (S. 2614) and the House in 2020 (H.R. 5710), would ban all non-competes except those associated with the sale of business or dissolution of or disassociation from a partnership, and impose civil penalties for violations. The bipartisan bill was reintroduced in the House (H.R. 1367) and Senate (S. 843) in February 2021.

The Current Non-Compete Legal Landscape Overview 2021-2022

- The enforcement of restrictive covenants is currently governed by state law
- Most jurisdictions enforce covenants not to compete—often based on common-law principles—if they are reasonable when taking into account:
  - Duration
  - Geographic scope
  - Substantive scope (i.e., a legitimate business interest for the restriction)
- The number of states that restrict the enforceability of non-competes in some way or make them largely unenforceable is increasing – as of January 1, 2022, more than half of the 50 states have some restrictions beyond the common-law principles.

The Current Non-Compete Legal Landscape Overview 2021-2022

- Some jurisdictions, such as Alabama, Florida, Georgia, Idaho and Texas, have statutes governing the enforceability of non-competes (e.g., Florida's statute specifies time periods that are considered presumptively reasonable or unreasonable)
- In a minority of jurisdictions, including California, North Dakota, Oklahoma and Washington DC, covenants not to compete are largely unenforceable, subject to limited exceptions (e.g., sale of a business)
- Illinois enacted a sweeping restriction to be effective January 1, 2022 – example of what may come in other states

More principles to keep in mind…

The Current Non-Compete Legal Landscape Overview 2021-2022

- Some of the new state law requirements apply to all agreements, including existing agreements, and some apply only to new agreements entered into after the effective date of the statute
- For those states that have implemented new procedural requirements or substantive restrictions, the exact terms of those requirements and restrictions vary significantly
- Many of the new statutes impose penalties on employers for entering into prohibited agreements

Recent Developments Across the US

In recent years, there has been an accelerating trend in other states adopting legislation that constrains the ability to use non-compete clauses with rank-and-file workers:

- Maine: Cannot enter into non-competes with employees who earn wages at or below 400% of the federal poverty level (currently approximately $51,520 for a one-person household)
- Maryland: Employees must earn more than $15/hour or $31,200/year
- Massachusetts: Non-competes are not enforceable against, inter alia, nonexempt employees
- New Jersey: Pending legislation prohibiting non-competes with nonexempt employees and "low-wage employees"
- Rhode Island: Non-competes are not enforceable against, inter alia, nonexempt employees and "low-wage employees" (i.e., employees whose average annual earnings don't exceed 250% of the federal poverty level for individuals)
- Virginia: Cannot enter into non-competes with "low-wage employees" based on fluctuating rate (currently employees who earn less than $1,195 per week (or $62,140 per year))

Recent Developments Across the US (cont'd)

A number of states have also recently enacted (or have pending) legislation that imposes significant restrictions on non-competes with employees regardless of income:

- Massachusetts: Imposes (a) prior notice requirements, (b) substantive limitations on scope and duration, (c) requirement on employers to pay 50% of the employee's salary throughout the non-compete period, and (d) prohibition on enforcement of non-competes with respect to employees who are terminated without cause or laid off
- New Jersey: Pending legislation would impose (a) prior notice requirements, (b) substantive limitations on scope and duration, and (c) requirement on employers to pay 100% of employee's regular compensation during non-compete period
- Oregon: Imposes (a) prior notice requirements in connection with entering non-competes, (b) substantive limitations on duration, and (c) requirement that employers pay 50% of the employee's salary and commissions throughout the non-compete period or 50% of the median family income for a four-person family

An Example
New Illinois Freedom to Work Act

- The Effective Date of the amendments to the Illinois Freedom to Work Act (IFWA) is January 1, 2022. (820 ILCS 90/99)
- Forward-looking only, so it does not invalidate any non-compete or non-solicitation agreement entered into or amended before January 1, 2022
- Employers can still get agreements in place before effective date
- Limits Covenants Not to Compete and Covenants Not to Solicit
- Compliant new covenants may still be added after January 1, 2022 if required procedures are followed

IFWA's New Requirements
What Covenants Are and Are Not Covered?

- "Covenant not to compete" includes two separate definitions. 820 ILCS 90/5
  - Agreement that restricts the employee from performing work for another employer (1) for a specified period of time; (2) in a specified geographic area; or (3) that is similar to the employee's work for the current employer
  - Agreement that "by its terms imposes adverse financial consequences on the former employee" for post-termination competitive activities
  - Seven categories excluded from statute (e.g., purchase/sale of business)
- "Covenant not to solicit" restricts the employee from (1) soliciting the employer's employees or (2) selling products or services to, or interfering in the employer's relationship with, existing and prospective clients, vendors, suppliers, or other business relationships. 820 ILCS 90/5.

IFWA's New Requirements
Required Notices By Employers to Employees

- Employers must provide employees/applicants with a copy of the non-compete and/or non-solicitation covenant "at least 14 calendar days" before employment commences or at least 14 calendar days to review the covenant. 820 ILCS 90/20
  - Employees voluntarily can choose to sign sooner than 14 days (much like ADEA/OWBPA releases)
- Employers must advise employees/applicants "in writing to consult with an attorney before entering into the covenant." 820 ILCS 90/20
  - Does it suffice to tell employees that they have the "right to consult with counsel" before signing such a covenant?

IFWA's New Requirements
Minimum Compensation Thresholds

- Minimum annual compensation thresholds, 820 ILCS 90/10
  - "Actual or expected annualized rate of earnings"
    - "Earnings" is broadly defined as earned salary, bonuses, commissions, or any other form of taxable compensation, plus any elective deferrals such as employee contributions to 401(k) and 403(b) plans, flexible spending accounts, etc. 820 ILCS 90/5
  - $45,000 for non-solicitation covenants, with step increases every five years
  - $75,000 for non-compete covenants, with step increases every five years

IFWA's New Requirements
COVID-Related Personnel Actions

- COVID-19 terminations, furloughs and layoffs, 820 ILCS 90/10(c)
  - Enforcement of non-competes and non-solicitation covenants generally prohibited if an employer "terminates or furloughs or lays off" an employee "as the result of business circumstances or governmental orders related to the COVID-19 pandemic or under circumstances that are similar to the COVID-19 pandemic"
  - Exception to the rule: Enforcement is permitted if the employer pays the employee an amount equivalent to the employee's base salary during the restricted period (minus compensation from subsequent employment)

IFWA's New Requirements
New Remedies and Enforcement Actions

- New remedies in private litigation, 820 ILCS 90/25
  - Applies to employer-initiated civil actions and arbitrations (including complaints as well as counterclaims)
  - Employee who prevails on a claim to enforce non-compete or non-solicit covenant "shall recover . . . all costs and all reasonable attorneys' fees"
- New actions and remedies in state enforcement, 820 ILCS 90/30
  - Investigations and "pattern or practice" claims by Illinois Attorney General
  - Remedies: Monetary damages to the State, restitution, injunctive relief
  - Civil penalties of $5,000 for each person; $10,000 for repeat violations

IFWA's New Requirements
What Is "Adequate Consideration" for the Covenant?

- IFWA now defines "adequate consideration," 820 ILCS 90/5
  - Two years of continued employment after signing covenant;
  - Shorter period plus "additional professional or financial benefits"; or
  - "Merely professional or financial benefits adequate by themselves"
- Codification of multi-factor test for enforceability. 820 ILCS 90/15
- IFWA codifies much of previous IL law in defining required "legitimate business interest". 820 ILCS 90/7 Yet…
  - "Totality of the facts and circumstances of the individual case"
  - No factor "carries any more weight than any other"
  - A contract can be reasonable and valid under one set of circumstances and unreasonable and invalid under another set of circumstances

IFWA's New Requirements
Reformation of Unenforceable Covenants

- Common law principles now included in the statute. 820 ILCS 90/35
- "Extensive judicial reformation . . . may be against the public policy . . . and a court may refrain from wholly rewriting contracts"
- A court "may, in its discretion, choose to reform or sever provisions"
- Factors relevant to determine whether reformation is appropriate:
  - Fairness of the restraints as originally written
  - The extent of the reformation
  - Is covenant a good faith effort to protect a legitimate business interest?
  - Whether parties included a clause authorizing such modifications

Forfeiture and Clawback for Competition

- As an alternative or adjunct to traditional non-compete provisions, employers may condition certain benefits and compensation on compliance with restrictive covenants
- Commonly used in equity plans and related incentive plans
- Companies might consider clawing back previously paid compensation, or seeking forfeiture of outstanding payments
- Enforceability will depend on type of restriction, type of benefit and applicable law:
  - "Pension" benefits subject to ERISA vesting and anti-alienation rules cannot be forfeited for violation of non-compete
  - Enforceability of forfeiture of benefits under ERISA "top hat" plan and welfare benefits depend on plan terms/federal principles of contract law

Forfeiture and Clawback for Competition (cont'd)

- Enforceability of forfeiture of benefits not subject to ERISA, (e.g., salary, overtime, stock options, RSUs, restricted stock, etc.) depends on applicable state law
  - State wage protection laws generally preclude clawback of wages or forfeiture of "earned" compensation
  - With regard to benefits that are not wages and not protected by ERISA, different states apply different tests for forfeiture provisions: Employee Choice Rule vs. Reasonableness Standard
    - Reasonableness Rule: Some courts treat forfeiture provisions as equivalent to direct non-competes and analyze under principles of reasonableness
    - Employee Choice Rule: Other states distinguish from non-competes and enforce without regard to reasonableness. Forfeiture provisions are enforceable if employees are given the choice of preserving their rights under contract by refraining from competition or risking forfeiture of such rights by exercising his right to compete.

Forfeiture and Clawback for Competition

- The enforceability of clawbacks (or forfeitures) tied to restrictive covenants may raise special questions of enforceability. States broadly have two approaches

Employee Choice Rule	Reasonableness Standard
Morris v. Schroder Capital Mgmt. Int'l, 859 N.E.2d 503 (N.Y. 2006)	Deming v. Nationwide Mut. Ins. Co., 905 A.2d 623 (Conn. 2006)
Exxon Mobil Corp. v. Drennen, 39 I.E.R. Cas. (BNA) 44, 164 Lab. Cas. (CCH) P 61515, 2014 WL 4782974 (Tex. 2014)	Pollard v. Autotote, Ltd., 852 F.2d, 72 (3d Cir. 1988), amended, 872 F.2d 1131 (3d Cir. 1988)
IBM v. Simonson, 988 N.Y.S.2d 523 (Table) (N.Y. Sup. Ct. 2014)	Cheney v. Automatic Sprinkler Corp. of Am., 385 N.E.2d 961 (Mass. 1979)

Forfeiture and Clawback for Competition

- In NY, forfeitures are enforced without regard to reasonableness if employee has effective "choice" to retain benefit of work for competitor (unless involuntarily terminated without cause). *DeVivo Assocs., Inc v. Nationwide Mut. Ins. Co.*, 797 F. App'x 661, 663 (2d Cir. 2020)
- In CA, restrictive covenants, including forfeiture provisions, are void. *Muggill v. Reuben H. Donnelly Corp.*, 62 Cal. 2d 239 (Cal. 1965)
    - Employer sought to enforce a contractual provision by which former employee would forfeit pension rights if he started working for a competitor
    - Court held that the provision was invalid under Business & Professions Code section 16600 et seq.

Forfeiture and Clawback for Competition

- *Tatom v. Ameritech Corp.*, 305 F.3d 737 (7th Cir. 2002)
  - Stock options provide employee with "right to acquire an ownership interest" and "a long-term stake in company"
  - Employee also has incentive to contribute to company's performance
  - Forfeiture keeps "option holder's interests aligned with the company's"
- *Viad Corp. v. Houghton*, 2010 WL 748089 (N.D. Ill. Feb. 26, 2010)
  - Summary judgment granted because employer's forfeiture clause "did not impoverish" defendant; instead, it "exacted a certain cost on her"

Forfeiture and Clawback for Competition

- *Raquet v. Allstate Corp.*, 501 F. Supp. 3d 630 (N.D. Ill. 2020)
  - Allstate's Equity Incentive Plans included broad forfeiture provisions
  - The forfeiture provision "simply divests employees from stock options if they do, in fact, compete."
  - Unlike traditional non-competes, "this one neither threatens the loss of regular or bonus compensation nor prevents Plaintiff from competing"
- IFWA's "second definition" of "covenant not to compete"
  - Covenant "by its terms imposes adverse financial consequences on the former employee if the employee engages in competitive activities"

Considerations When Drafting Restrictive Covenants

- Important to remember that there are different types of restrictive covenants in addition to non-competition covenants that are often helpful to employers and may be subject to fewer restrictions/scrutiny:
  - Most states allow non-disclosure (confidentiality) agreements and restrictions on competition using trade secrets
  - Non-solicitation of customers' covenants are often treated differently (more favorably) than covenants not to compete (e.g., Oregon, Georgia)
  - Non-solicitation of employees' restrictive covenants are enforceable in most jurisdictions

Considerations When Drafting Restrictive Covenants

- Unless prohibited by state law, be strategic about selecting governing law and venue. Courts often enforce contractual choice of law and venue provisions, especially if the selected jurisdiction has a substantial relationship to the parties or transaction
- Ensure that there is adequate consideration under the circumstances in connection with entering into the agreement (especially if the restriction is entered into during the employment relationship)
- Be strategic about which restrictions to impose on different categories of employees based on their roles, training received and the Company's protectable business interest in imposing a restriction
  - Non-solicitation for some employees and non-compete for others?
  - Beware of the "janitor rule" in applicable jurisdictions

Considerations When Drafting Restrictive Covenants

- Include a tolling provision providing that in the event of a breach, the restricted period is extended by the amount of time the covenant was breached
- Call out injunctive relief as a remedy to a breach
- Specify a non-exhaustive list of legitimate business interests
- Ensure agreements explicitly call for reformation
- Include pro-employer language on fees/costs if employer prevails
- Train recruiters, interviewers, HR teams and management on new state law requirements
- Ensure offer letters, employment agreements satisfy state law requirements

Considerations When Drafting Restrictive Covenants
Including Arbitration Provisions

- Restrictive covenants litigation is often the subject of intense, costly and public litigation
- Potential advantages of arbitration
  - Increased confidentiality
  - Less adversarial
  - Arbitrator with subject-matter expertise
- Potential disadvantages of arbitration
  - Restrictive covenants litigation often involves third parties, such as the new employer, who cannot be included in the arbitration proceeding
  - Could increase the cost of litigation due to obligation to pay arbitrator's costs

Considerations When Drafting Restrictive Covenants
Including Arbitration Provisions

- Various options
  - State that the arbitration agreement does not apply to disputes arising from the restrictive covenants
  - Incorporate the arbitration agreement into the non-compete in total (or in part)
  - Supersede the arbitration agreement in the non-compete in total (or in part)
  - Exclude claims where a party wants to add a third party (carefully define the third parties)
  - Unilateral arbitration election clause
    - Subject to unconscionability challenges based on lack of mutuality of obligation

Lessons Learned from Litigation

- Helpful to have an alert that identifies when employees download sensitive or large volumes of information to personal devices or email it to themselves
- Ensure company has protocols in place with respect to protecting confidential information/trade secrets (e.g., ensuring that only employees who need to have access can access)
- Require employees to sign a certification indicating return or deletion of all company information
- Important to act quickly and decisively once Company becomes aware of former employee misconduct
- Provide employees subject to restrictive covenants with reminder notices upon termination of their continuing contractual obligations
- Document specialized training provided to employees

Benefits & Compensation University: Upcoming Events

- October 27, 2021: Latest ERISA Developments and Trends

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