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THE PIB REPORT

New Massachusetts Law Limits Noncompete Agreements

On October 1, 2018, Massachusetts' new noncompete law for employers and employees went into effect. This law significantly limits the use of noncompete agreements within the Commonwealth, and incorporates additional unique wholesale changes. Below are highlights of certain provisions of the new law, along with recommendations on how employers can address their existing and future noncompete agreements to comport with the new law.

What is a noncompete agreement?

The new law defines a "noncompetition agreement" as "an agreement between an employer and an employee, or otherwise arising out of an existing or anticipated employment relationship, under which the employee or expected employee agrees that the employee will not engage in certain specified activities competitive with the employee's employer after the employment relationship has ended."

New Law Is Limited to Noncompetes with "Employees," Including Independent Contractors; Certain Employees Are Exempt

The new law is limited to noncompete agreements with "employees." The definition of a covered "employee" includes independent contractors, which is not common in other states' noncompete laws. Notwithstanding this definition, noncompete agreements are not enforceable against employees who are:

- Undergraduate or graduate students with an internship or short-term employment relationship (whether paid or unpaid);
- 18 years old or younger;
- Hourly employees; or
- Terminated without cause or laid off (this last category is a significant difference from most states' noncompete laws).

Technical and Timing Requirements

To be enforceable, noncompete agreements must meet certain basic technical and timing requirements. All agreements must:

- Be in writing;
- Be signed by both the employer and employee; and
- Expressly state that the employee has the right to consult with an attorney prior to signing.

There are also timing requirements for execution of the agreement:

- If a noncompete is signed at the commencement of employment, it must be provided to the employee by the earlier of a formal offer of employment or 10 business days before commencement of employment.
- If the noncompete is entered into after commencement of employment but not in connection with the separation from employment it must be provided at least 10 business days before the agreement is to be effective. In addition, it must be supported by fair and reasonable consideration independent from the continuation of employment. It is not currently clear as to what is considered "fair and reasonable consideration" (see the Garden Leave Requirement section below).

Reasonableness Requirements, Including "Presumption" of Reasonableness

To be enforceable, noncompete agreements must be reasonable in scope and duration. Specifically, they must:

- *Be no broader than necessary to protect one or more of the following legitimate business interests of the employer: (1) the employer's trade secrets; (2) the employer's confidential information; or (3) the employer's goodwill.* A noncompete agreement is presumed necessary where the legitimate business

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interest cannot be adequately protected through an alternative restrictive covenant such as a nonsolicitation or confidentiality covenant.

- *Not include a term of more than one year from the date of cessation of employment.* The term may be up to two years if the employee has breached a fiduciary duty or has unlawfully taken (physically or electronically) property belonging to the employer.
- *Be reasonable in geographic reach.* A geographic reach is presumptively reasonable if it limited to only the geographic areas in which the employee, during any time within the last two years of employment, provided services or had a material presence or influence.
- *Be reasonable in the scope of prohibited activities*. A restriction is presumptively reasonable if it is on activities limited to only the specific types of services provided by the employee at any time during the last two years of employment.

Garden Leave/Consideration Requirement

One of the most unique requirements of the new law is that noncompete agreements must include a "garden leave" clause or other mutually agreed upon consideration. Under a garden leave clause, for the duration of the noncompete period, an employer must pay the employee for at least 50% of the employee's highest salary within the last two years of employment. The employer's obligation to pay the garden leave is excused only if the employee breaches the agreement.

The garden leave requirement, in itself, may deter some employers from requiring non-competes. In lieu of this provision, some employers may rely on the "other mutually-agreed upon consideration" provision. The law does not include any specifics on the amount or timing of other consideration that would be presumptively sufficient (*e.g.*, it does not require that the consideration be at least as much as the garden leave amount). Accordingly, it leaves open the possibility of providing an amount of separate consideration at the time of execution of the agreement (such as a signing bonus). Relying on the other consideration provision, however, is inherently riskier, since there is no current case law or guidance as what makes such other consideration sufficient. In any event, in such event, the employer should expressly designate the applicable "other consideration" as being specific consideration for the noncompete covenant.

Choice of Law; Blue-Pencil

Employers cannot avoid the Massachusetts law by including another state in the governing law provision. The law applies to employees who have lived in Massachusetts for at least 30 days prior to termination, regardless of the governing law state. Lawsuits and other challenges must be brought in the county where the employee lives, or in Suffolk County Superior Court (which includes Boston) if the parties agree.

The law also allows courts to modify noncompete agreements to make them valid and enforceable (called "blue penciling"), to the extent necessary to protect the employer's legitimate business interest. However, modification is within the court's discretion, so employers should not rely on blue penciling to save a non-compete that would otherwise be prohibited.

Types of Agreements Not Covered by the New Law

The following are some of the types of agreements that are not covered by the new law:

- Employee non-solicitation covenants;
- Customer/Client/Vendor non-solicitation covenants;
- Nondisclosure/Confidentiality agreements;
- Noncompete agreements made in connection with the sale of the assets or equity of a business (when the party restricted is a significant owner of, or member or partner in, the business entity who will receive significant consideration or benefit from the sale);
- Noncompete agreements outside of an employment relationship; and
- Noncompete agreements made in connection with the cessation of or separation from employment if the employee is expressly given seven business days to rescind acceptance.

So – What Should Employers Do?

- Employers should reconsider their noncompete strategy and determine the set of employees for whom they will require noncompete agreements, as well as what consideration they will offer such employees (particularly given the garden leave requirements). For example, employers may require noncompete agreements only for officers or other key employees that would present a significant risk to their business if the employee departed to work for a competitor.
- Employers should revise their form noncompete agreements to comply with the new law, as well as any related human resource policies (e.g. offer letters);

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- Employers should consider having their current employees execute new noncompete agreements in compliance with the new law to avoid potential issues with the enforcement of the existing agreements. However, this would require additional consideration for such employees. ■

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United States Supreme Court Holds That SEC Judges Are Officers Subject to the Constitution's Appointments Clause

In *Lucia v. Securities and Exchange Commission*, 585 U.S. ___ (2018), the United States Supreme Court held that administrative law judges ("ALJs") of the U.S. Securities and Exchange Commission (the "SEC") are "Officers of the United States" subject to the Constitution's Appointments Clause. This clause provides that only the President, "Courts of Law," or "Heads of Departments" can appoint such "Officers." *Lucia* reversed the Court of Appeals for D.C. Circuit, which had held that SEC ALJs are not Officers, but merely employees not subject to the Appointments Clause. The impact of the *Lucia* decision is significant, as it will provide an opportunity for rehearing for litigants in a wide array of cases heard by ALJs across the federal government on the grounds that the ALJ was improperly appointed.

The case began through an administrative proceeding by the SEC against an investment advisor, Raymond Lucia, who was charged with violations of the Investment Advisers Act, § 80b-1 *et seq*. The case was assigned to an ALJ to adjudicate the case, and the ALJ found statutory violations and imposed a civil money penalty and lifetime ban as an investment advisor. On appeal to the SEC, Lucia argued that the administrative proceeding was invalid because the ALJ had not been appointed by SEC staff members, not the Commission itself as "Head of Department," and therefore the ALJ lacked constitutional authority to do his job. The SEC rejected Lucia's argument, holding that the SEC's ALJs are not "Officers of the United States," but rather "mere employees," or officials with lesser responsibilities who fall outside of the Appointments Clause as they do not exercise significant authority independent of the SEC's supervision. On appeal, a panel of the D.C. Circuit agreed with the SEC, and after Lucia petitioned for rehearing, the full D.C. Circuit sitting *en banc* divided evenly, resulting in a *per curiam* order denying Lucia's claim. That decision conflicted with a Tenth Circuit decision, *Bandimere v. SEC*, 844 F.3d 1168, 1179 (2016), which held that SEC ALJs are subject to the Appointments Clause. In November 2017, the Trump Administration reversed the position of the Obama Administration and advocated for the Court to find the ALJs to be officers subject to the Appointments Clause, leading the Supreme Court to appoint counsel to represent the SEC's former position.

In resolving the split in circuits, the Supreme Court cited to *United States v. Germaine*, 99 U.S. 508 (1878), and *Buckley v. Valeo*, 424 U.S. 1 (1976), as providing the basic framework for distinguishing between officers and employees, including that the individual must occupy a "continuing" position established by law and "exercise significant authority pursuant to the laws of the United States." Applying that framework, the Court cited to *Freytag v. Commissioner*, 501 U.S. 868 (1991), which held that Special Trial Judges ("STJs") of the U.S. Tax Court are "officers" subject to the Appointments Clause. The majority opinion, written by Justice Elena Kagan, found that "[t]he Commission's ALJs, like the Tax Court's STJs, hold a continuing office established by law" and that "they exercise the same 'significant discretion' when carrying out the same 'important functions' as STJs do."

Chief Justice John Roberts and Justices Anthony Kennedy and Samuel Alito joined Kagan in the opinion. Justices Clarence Thomas and Neil Gorsuch concurred in the 6-3 majority, but noted that Freytag would not necessarily apply to all ALJ cases. Justices Ruth Bader Ginsburg

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and Sonia Sotomayor dissented on the grounds that ALJs do not have "significant authority," since they merely advise and make recommendations to others and do not have final, binding authority. Justice Stephen Breyer concurred in part and dissented in part, agreeing that the appointment of the ALJ was invalid but on statutory, not constitutional grounds.

The impact of the *Lucia* decision extends beyond the SEC, and calls into question any pending or recently decided enforcement action before hundreds of ALJs serving across all federal agencies, including Consumer Financial Protection Bureau ("CFPB"). ALJs are appointed pursuant to 5 U.S.C. § 3105, which states that "each agency shall appoint as many ALJs as are necessary for proceedings required to be conducted." The process for appointing ALJs differs across agencies. In reaction to *Lucia*, President Trump issued an Executive Order on July 10, 2018 which eliminated the competitive examination and selection procedures for ALJs. While this will result in an appointment process similar to federal judicial appointments versus a career civil service appointment, it removes the vetting process of the Office of Personnel Management and opens the door to increased politicization of ALJ selection.

PIB Law regularly advises on a wide range of regulatory enforcement matters. If you would like additional information on the *Lucia* decision and its impact on your business, please contact Brian Turetsky at brian.turetsky@piblaw.com or James P. Berg at james.berg@piblaw.com. ■

Supreme Court Rules Plaintiffs May Not Bring Successive Class Actions After the Statute of Limitations Has Run

This summer, the United States Supreme Court issued a decision in *China Agritech Inc. v. Resh*, preventing plaintiffs from bringing successive class actions after the statute of limitations has run. This ruling constitutes a major victory for defendants in federal class action lawsuits, and a significant narrowing of the tolling provisions established by the Supreme Court's ruling in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974).

In *American Pipe*, the Supreme Court found that the filing of a class action tolls the statute of limitations for members of the proposed class, so long as their claims are within the scope of the pending class action. The Supreme Court was concerned that letting the statute of limitations run during that time period would require potential class members to safeguard their rights by intervening or filing separate actions, even while the potential class action was pending, which would undermine the efficiency goals of the class action procedural vehicle. *See id*. at 554; *Crown, Cork & Seal Co., Inc. v. Parker*, 462 U.S. 345 (1983). The Supreme Court later expanded the *American Pipe* doctrine to hold: (1) commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action; (2) the statutory period remain tolled for all members of the putative class until class certification is denied; and (3) class members may choose to file their own suits or to intervene as plaintiffs in the pending action. *See Crown*, 462 U.S. at 353-54.

Left unanswered by the ruling in *American Pipe* was the question of whether the tolling effect was limited to subsequent claims asserted by individuals or also included successive class actions. The ambiguity over to whom the benefit of the *American Pipe* tolling effect inures led to a circuit split, with the First, Second, Third, Fifth, Eight, and Eleventh Circuits finding that the statute of limitations for class action claims was only tolled for subsequent claims asserted by individuals, and the Sixth, Seventh, and Ninth Circuits extending the benefit to those claimants seeking to file successive class actions as well. Key to the Sixth, Seventh, and Ninth Circuits' rulings was the belief that absent class members of an uncertified class should not be subject to issue preclusion, and that concerns over stacking class action lawsuits are appropriately addressed by "existing principles in our legal system, such as stare decisis and *comity among courts." Phipps v. Wal-Mart Stores, Inc.*, 792 F.3d 637, 653 (6th Cir. 2015). This argument was roundly rejected by the Supreme Court in China Agritech.

China Agritech Inc., a manufacturer of agricultural products selling primarily to Chinese farmers, faced a third class action from shareholders regarding allegedly fraudulent business practices pursuant to the Securities Exchange Act of 1934 (the "1934 Act"), and following the denial of class certification in two prior class actions. China Agritech moved to dismiss based on the two-year statute of limitations under the 1934

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Act, and the district court granted that motion. An appeal by the shareholders to the Ninth Circuit followed, and in keeping with the Sixth Circuit's ruling in *Phipps*, the Ninth Circuit found that the statute of limitations was tolled pursuant to *American Pipe*. The shareholders next appealed to the Supreme Court, which granted certiorari.

In an 8-1 opinion, the Supreme Court ruled that *American Pipe* did not provide for tolling of "piggyback" class actions. In reaching this conclusion, the Supreme Court sought to stay faithful to Rule 23(c) of the Federal Rules of Civil Procedure and maintain judicial economy. The Supreme Court reasoned that tolling of subsequent individual claims pursuant to *American Pipe* was in the interest of judicial economy because it avoided a rush of litigants filing separate actions seeking to avoid being locked out by the statute of limitations while certification of a class was still pending. On the other hand, the Supreme Court found that allowing the tolling provision of *American Pipe* to be extended to successive class actions would abrogate the purpose of Rule 23(c).

With this ruling, defendants in class action litigation that defeat class certification may see subsequent class actions arising out of the same operative facts become time-barred without the availability of the *American Pipe* tolling provision to potential plaintiffs. Instead, defendants may begin to see multiple class action lawsuits filed simultaneously, more intervenors, and potentially more pressure from plaintiffs and courts seeking adjudication of class certification prior to any statute of limitations running.■

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