IslerDare PC
Client Alert

EMPLOYMENT LAW UPDATE

Virginia Bans Non-Competes For "Low-Wage" Earners

For decades, Virginia employers have relied on various types of "non-compete" agreements to limit competition from former employees, although historically these types of agreements were limited to employees who were in sales or customer facing.

However, over the last 30 years, employers have expanded the use of these non-competes to even entry-level employees. Although these agreements could be enforced if they were narrowly drawn to protect the employer's legitimate business interest, Virginia courts repeatedly have made clear that non-compete agreements are disfavored restraints on trade. Still, despite this caution, employers have expanded the use of non-competes, and this pervasive use of these agreements has now led the General Assembly to take action to curb the use of such agreements.

On April 9, 2020, Governor Northam signed House Bill 330 into law. The new law, which goes into effect **July 1, 2020**, prevents employers from entering into, enforcing, or threatening to enforce covenants not to compete (i.e., non-compete agreements) against so-called "low-wage employees." The law will have significant ramifications for many Virginia employers who rely on non-competes to prevent post-employment competition, so employers must understand the basics.

The Basics

Prohibited Agreements. Effective July 1, 2020, employers cannot enter into, enforce, or attempt to enforce covenants not to compete against low-wage employees.

The law defines a "covenant not to compete" as an agreement that "restrains, prohibits, or otherwise restricts an individual's ability, following the termination of the individual's employment, to compete with his former employer." The law expressly prohibits agreements that "restrict an employee from providing a service to a customer or client of the employer if the employee does not initiate contact with or solicit the customer or client."

Grandfathered Agreements. It is important to note that covenants that were entered into prior to July 1, 2020, can still be enforced, even after July 1, 2020.

Confidentiality Agreements Permitted. The law explicitly permits confidential information nondisclosure agreements intended to prevent employees from taking/using an employer's trade secrets and confidential and proprietary information. In other words, while employers cannot restrict competition by "low-wage employees," they can still protect confidential information and trade secrets.

Low-Wage Employees. Perhaps the most challenging and surprising part of the law is the relatively high dollar threshold used to define low-wage workers. The law defines "low-wage employees" as:

- An employee whose average weekly earnings are less than the average weekly wage of the Commonwealth.
    - The "average weekly wage of the Commonwealth" is equal to the maximum workers' compensation benefits allowed by the Virginia Worker's Compensation Commission. As of July 1, 2020, the rate will be **$1,137 per week**. That works out to **$59,124** annually.
- Interns, students, apprentices, or trainees employed, with or without pay, at a trade or occupation in order to gain work or educational experience.
- Independent contractors who are compensated at an hourly rate that is less than the median hourly wage for the Commonwealth for all occupations as reported, for the preceding year, by the Bureau of Labor Statistics.

Exception for Sales Personnel. Employees "whose earnings are derived, in whole or in predominant part, from sales commissions, incentives, or bonuses" are **not** included in the definition of low-wage employees. That means commissioned salespeople are not covered by the law, regardless of how much they make.

Posting Requirements. Employers are required to post a copy of the law where other required posters are posted. Attached to this Client Alert is a copy of the bill that can be used for posting.

Private Right of Action and Fines. There are some fairly stiff penalties for employers that do not comply with the law:

- A low-wage employee may bring a lawsuit against his or her former employer "or other person that attempts to enforce a covenant not to compete." If the employee is successful, the court can: (1) void the covenant not to compete; (2) enter an injunction preventing the former employer from taking further steps to enforce the covenant not to compete; (3) order payment of liquidated damages by the employer; and (4) award lost compensation, damages, and reasonable attorneys' fees and costs.

- The availability of attorneys' fees will make this attractive for plaintiffs' attorneys.

- Any employer found to have entered into, enforced, or threatened to enforce a covenant not to compete against a low-wage employee *will* be fined $10,000 for each violation.
  - Note that the law contains mandatory language (*i.e.*, "shall") with respect to the $10,000 fine.

- Any employer who fails to comply with the law's posting requirements will receive a written warning for the first violation, a fine of up to $250 for a second violation, and a fine of up to $1,000 for each additional violation.

Anticipated Questions

Q1. Are existing covenants not to compete with "low-wage employees" now unlawful?

The law applies to covenants not to compete entered into on or after July 1, 2020, so pre-existing non-compete agreements will remain lawful and enforceable (subject to the usual requirements). That said, in light of the new law, it remains to be seen whether Virginia courts will have an appetite to enforce existing non-competes against what will now be considered low-wage employees.

Q2. What does "predominant part" mean for purposes of the exception for employees whose earnings are derived "in whole or in predominant part" from commissions, incentives, or bonuses?

Unclear. This will likely be the subject of litigation because the law does not provide an answer to this question. Most likely, the courts will conclude that predominant means more than 50% of the employee's pay is derived from some form of incentive compensation. Until the courts provide clarity on this issue, the only approach without any risk is to limit covenants not to compete for those making less than $59,124 annually to employees whose earnings are derived "in whole" from commissions, incentives, or bonuses.

Q3. Can employees sign "customer non-solicitation" agreements provided the agreements only restrict the employees from providing services if they initiate contact?

That is also somewhat unclear at this point. The confusion arises from the following definition of "covenant not to compete" in the law:

> "Covenant not to compete" means a covenant or agreement, including a provision of a contract of employment, between an employer and employee that restrains, prohibits, or otherwise restricts an individual's ability, following the termination of the individual's employment, to compete with his former employer. *A "covenant not to compete" shall not restrict an employee from providing a service to a customer or client of the employer if the employee does not initiate contact with or solicit the customer or client.*

So, while the definition specifically calls out restrictions on providing services where the employee does not initiate contact, the general definition of "covenant not to compete" is much broader. Until there is greater clarity on the issue, the safest approach is to avoid all agreements that restrict an employee's ability to compete following his or her termination of employment.

Q4. Does the new law prevent non-compete clauses in employee separation agreements?

Yes, if the individual was a low-wage employee. The law is not limited to standalone non-compete agreements. The use of the phrase "covenant or agreement" in the definition of "covenant not to compete" is meant to include all such restrictions on competition for low-wage employees.

Q5. How do you calculate an employee's average weekly earnings?

Divide the employee's earnings during the 52 weeks immediately before the date of termination of employment by 52. If the employee worked fewer than 52 weeks, divide by the number of weeks that the employee was actually paid during the 52-week period.

Q6. Is Virginia the only state with a law like this?

No, Virginia joins several other states that restrict the use of covenants not to compete with low-wage employees. That said, Virginia's "low wage" threshold is significantly higher than several other states. For example, Maryland bars non-compete agreements for employees earning $31,200 per year or less. In New Hampshire, non-compete agreements are restricted for individuals earning less than $24,280.

Q7. What happens if, after July 1, 2020, I enter into a covenant not to compete with an employee making $60,000, but the average weekly wage of the Commonwealth increases next year to above $60,000?

The agreement would no longer be enforceable. The agreement itself would not violate the law because when it was entered into, the individual was not a "low-

wage employee", but any subsequent attempts to enforce the agreement would be unlawful. For that reason, employers should review their existing non-compete agreements before the new rate goes into effect on July 1st of each year to ensure compliance. For reference, the 2018 weekly rate was $1,082 ($56,264 annually); and the 2019 weekly rate was $1,102 ($57,304 annually). Based on these numbers, it is likely the "low-wage" threshold will exceed $60,000 in 2021.

Action Items for Employers

In light of the new law, employers should immediately take the following steps:

1. By July 1, 2020, post a copy of the new law. We have included a printable version that you can post with your other employment law posters.

2. By July 1, 2020, review your new hiring packet to ensure that you are not including as part of the standard packet some form of postemployment noncompetition restriction for your workers making $60,000 or less (except, as noted, for your sales personnel).

More Questions?
We are here to help.

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Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Article 1 of Chapter 3 of Title 40.1 the following:
Virginia Code § 40.1-28.7:7. Covenants not to compete prohibited as to low-wage employees; civil penalty.

A. As used in this section:

"Covenant not to compete" means a covenant or agreement, including a provision of a contract of employment, between an employer and employee that restrains, prohibits, or otherwise restricts an individual's ability, following the termination of the individual's employment, to compete with his former employer. A "covenant not to compete" shall not restrict an employee from providing a service to a customer or client of the employer if the employee does not initiate contact with or solicit the customer or client.

"Low-wage employee" means an employee whose average weekly earnings, calculated by dividing the employee's earnings during the period of 52 weeks immediately preceding the date of termination of employment by 52, or if an employee worked fewer than 52 weeks, by the number of weeks that the employee was actually paid during the 52-week period, are less than the average weekly wage of the Commonwealth as determined pursuant to subsection B of § 65.2-500. "Low-wage employee" includes interns, students, apprentices, or trainees employed, with or without pay, at a trade or occupation in order to gain work or educational experience. "Low-wage employee" also includes an individual who has independently contracted with another person to perform services independent of an employment relationship and who is compensated for such services by such person at an hourly rate that is less than the median hourly wage for the Commonwealth for all occupations as reported, for the preceding year, by the Bureau of Labor Statistics of the U.S. Department of Labor. For the purposes of this section, "low-wage employee" shall not include any employee whose earnings are derived, in whole or in predominant part, from sales commissions, incentives, or bonuses paid to the employee by the employer.

B. No employer shall enter into, enforce, or threaten to enforce a covenant not to compete with any low-wage employee.

C. Nothing in this section shall serve to limit the creation or application of nondisclosure agreements intended to prohibit the taking, misappropriating, threatening to misappropriate, or sharing of certain information, including trade secrets, as defined in § 59.1-336, and proprietary or confidential information.

D. A low-wage employee may bring a civil action in a court of competent jurisdiction against any former employer or other person that attempts to enforce a covenant not to compete against such employee in violation of this section. An action under this section shall be brought within two years of the latter of (i) the date the covenant not to compete was signed, (ii) the date the low-wage employee learns of the covenant not to compete, (iii) the date the employment relationship is terminated, or (iv) the date the employer takes any step to enforce the covenant not to compete. The court shall have jurisdiction to void any covenant not to compete with a low-wage employee and to order all appropriate relief, including enjoining the conduct of any person or employer, ordering payment of liquidated damages, and awarding lost compensation, damages, and reasonable attorney fees and costs. No employer may discharge, threaten, or otherwise discriminate or retaliate against a low-wage employee for bringing a civil action pursuant to this section.

E. Any employer that violates the provisions of subsection B as determined by the Commissioner shall be subject to a civil penalty of $10,000 for each violation. Civil penalties owed under this subsection shall be paid to the Commissioner for deposit in the general fund.

F. If the court finds a violation of the provisions of this section, the plaintiff shall be entitled to recover reasonable costs, including costs and reasonable fees for expert witnesses, and attorney fees from the former employer or other person who attempts to enforce a covenant not to compete against such plaintiff.

G. Every employer shall post a copy of this section or a summary approved by the Department in the same location where other employee notices required by state or federal law are posted. An employer that fails to post a copy of this section or an approved summary of this section shall be issued by the Department a written warning for the first violation, shall be subject to a civil penalty not to exceed $250 for a second violation, and shall be subject to a civil penalty not to exceed $1,000 for a third and each subsequent violation as determined by the Commissioner. Civil penalties owed under this subsection shall be paid to the Commissioner for deposit in the general fund.

The Commissioner shall prescribe procedures for the payment of proposed assessments of penalties that are not contested by employers. Such procedures shall include provisions for an employer to consent to abatement of the alleged violation and to pay a proposed penalty or a negotiated sum in lieu of such penalty without admission of any civil liability arising from such alleged violation.

2. That the provisions of this act shall be applicable to covenants not to compete that are entered into on or after July 1, 2020.