

Noncompete Update: Bans, New Limitations and Restrictions

November 3, 2023
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Employers should remain vigilant, adapt their practices, and explore alternative measures to protect their interests in the face of shifting legal frameworks and heightened scrutiny of non-compete agreements.

The Legal Intelligencer

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In today's rapidly changing business environment, the utilization and enforcement of noncompete agreements and restrictive covenants have become central to maintaining a competitive edge. As businesses adapt to new economic, technological, and workforce dynamics, the legal frameworks surrounding these agreements are also evolving. Notably, two federal agencies are actively working to diminish the prevalence of noncompete agreements. An increasing number of states are joining the ranks of jurisdictions that either prohibit or place significant restrictions on noncompetes, including many nonsolicitation agreements, by enacting comprehensive bans or introducing new limitations. Meanwhile, certain states, while not entirely banning noncompetes, have introduced fresh restrictions. In addition, courts are recognizing novel legal theories for challenging these agreements.

Nevertheless, there are still scenarios in which employers can utilize noncompete agreements to safeguard their proprietary information and defend against unfair competition. However, there are formidable new obstacles to overcome, and the regulatory landscape may change in the near future.

Recent Key Regulatory Changes

On Jan. 5, 2023, the Federal Trade Commission (FTC) introduced a proposed rule aimed at banning most noncompete agreements in the United States on the basis that they constitute unfair methods of competition. The FTC's proposal attracted significant attention and the public comment period closed on March 20. The FTC has yet to issue a final rule or provide a timeline for doing so; observers closely following the proposed ban do not anticipate a final FTC rule until April 2024 at the earliest.

When (and if) the FTC issues the final rule, it will be subject to numerous court challenges by a variety of private entities, including the U.S. Chamber of Commerce. It is unclear whether the final rule will survive attack. Basis for attack include the FTC Act's own limitations on the FTC's authority vis-à-vis the history of Section 6(g) and unfair competition; the U.S. Supreme Court's aversion to upholding federal agency rules when scrutinized under the "major questions" doctrine; the rule itself being an improper delegation of legislative authority under the nondelegation doctrine; and the everchanging political landscape.

Despite these challenges, federal agencies are increasingly utilizing new methods to challenge noncompete agreements. This includes an increasing number of antitrust claims targeting traditional noncompetes (and not just no-poach agreements), along with intra-agency cooperation between the FTC, the U.S. Department of Labor, and the National Labor Relations Board (NLRB) to help regulate noncompetes.

The NLRB's general counsel, Jennifer Abruzzo, has taken her own stand on noncompete agreements. On May 30, Abruzzo issued a memorandum expressing her view that most post-employment, noncompete and nonsolicitation agreements violate the National Labor Relations Act (NLRA). In the memorandum, addressed to all regional directors, officers-in-charge and resident officers, Abruzzo asserted that these agreements impede the exercise of Section 7 rights under the NLRA for nonsupervisory employees. She opined that, with few exceptions, the offering, maintenance, and enforcement of such agreements likely violate Section 8(a)(1) of the NLRA. While the NLRB itself had not yet ruled on Abruzzo's position, it could issue a ruling soon that broadly prohibits non-competition (and nonsolicitation) agreements.

Jurisdiction-Specific Challenges to Noncompetes

The landscape has also been altered by new state laws. Five states, namely California, Colorado, Minnesota, North Dakota and Oklahoma, have instituted comprehensive bans on virtually all noncompetes with very limited exceptions, such as for certain business sales. California has strengthened its existing noncompete ban, granting employees the ability to obtain attorney fees for successful challenges. Several other states are considering similar laws. On June 20, the New York State Legislature passed a bill banning post-employment noncompetition agreements. While Gov. Kathy Hochul has yet to sign the bill, she has until the end of the year to do so.

States that do permit noncompetes are enacting broader restrictions. Over 20 states prohibit various categories of noncompetes, including laws that ban all no-poach agreements and all traditional noncompetes for employees earning less than a specific salary threshold. A growing trend is legislation requiring that employers give individuals advance notice (or a "consideration period") before the employee can sign a restrictive covenant agreement. Employers in all states, even those without specific laws, must satisfy a common law test for enforcing a noncompete, demonstrating that it is necessary and narrowly tailored to protect a legitimate business interest, typically in terms of geographic scope and duration.

Employer Response: Stay Alert and Be Proactive

Employers currently using noncompete agreements should assess their current approach and formulate contingency plans for a future where noncompetes might become illegal. While it may take time for a broad noncompete ban to take effect, existing agreements may not be "grandfathered" in or exempted, necessitating alternative safeguards for proprietary information and competitive defense.

It is also time to consider other options for protecting business interests. This includes bolstering confidentiality agreements to address gaps left by noncompete bans. Well-drafted confidentiality agreements, coupled with remedies for violations, can offer effective protection for proprietary information.

Existing laws like the federal Defend Trade Secrets Act and state laws can serve as alternatives to noncompetes in safeguarding trade secrets. Employers should ensure they treat key proprietary information as trade secrets and consider including arbitration clauses and other provisions for securing relief in their agreements.

Modifying employee compensation structures may also discourage unfair competition. For example, introducing longevity bonuses and seniority-based pay raises may deter departures of senior employees who pose a competitive threat. Improving training can also help fill gaps left by noncompete bans. When pursuing mergers, acquisitions, or other deals, account for the evolving legal landscape. Ensure that agreements provide adequate protection in the event of noncompete bans or increased restrictions.

Employers should also begin utilizing noncompetes strategically, rather than applying a one-size-fits-all approach to all employees. Overly broad usage may invite scrutiny and threaten the enforceability of truly important agreements for key employees. In other words: treat noncompetes as a precise tool, not a weapon of mass destruction. Employers should remain

vigilant, adapt their practices, and explore alternative measures to protect their interests in the face of shifting legal frameworks and heightened scrutiny of noncompete agreements.

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