

Non-competition Agreements under Scrutiny at State and Federal Level

by Matthew M. Durham and Briana Al Taqatqa

Employee restrictive covenants, in particular non-competition agreements, are under scrutiny at the state and federal level. State legislatures are working to narrow the circumstances under which restrictive covenants may be enforced. Likewise, the federal government is taking steps to act on President Biden's 2021 Executive Order on Promoting Competition in the American Economy. Courts are also showing an increasing unwillingness to enforce non-competes in certain circumstances. This article provides an overview on the general trend toward limiting the use of employee non-compete agreements and recommendations for employers seeking to use restrictive covenants to protect their business interests.

Overview of Legal Trends

In 2022, five states and the District of Columbia effected legislation designed to limit the use of non-compete agreements. Approximately 18 more states have proposed or pending legislation. State laws designed to limit the use of restrictive covenants vary significantly. For example, California; North Dakota; Oklahoma; and Washington, D.C., ban non-compete agreements outright with a few narrow exceptions. Colorado, Illinois, Maine, Maryland, New Hampshire, Oregon, Rhode Island, Virginia, and Washington prohibit non-compete agreements unless the employee earns above a certain salary threshold. Other states, like Iowa and Kentucky, limit the use of non-competes for certain professions such as healthcare workers.

Trends in recently enacted state legislation include:

- Limiting use to the protection of trade secrets
- Minimum salary thresholds
- Term limits on post-employment restrictions
- Employee notice and "time to consider" requirements
- Limiting legal recourse against employees

The federal government is also taking steps to limit the use of employee non-compete

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agreements. On January 6, 2023, the Federal Trade Commission proposed a new rule, which if enacted, would amount to a near-total ban on the use of non-compete agreements. The one exception would allow non-compete agreements by owners in the connection with the sale of a business, a common carve out. The FTC voted 3-1 to publish the Notice of Proposed Rulemaking, which will be subject to a 60-day period of public comment. The proposed rule comes in response to President Biden's Executive Order 14036 directing the FTC to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."

If enacted, a federal rule would preempt and supersede any state statute, regulation, or order inconsistent with the provisions of the final rule, unless state law provides greater worker protections. However, there will likely be significant legal challenges to any FTC final rule banning non-competes.

Most critically, it is unclear whether the FTC has authority to issue a nationwide ban on non-competes. The FTC cites Section 5 of the FTC Act (15 U.S.C. § 45), which prohibits unfair methods of competition and unfair practices affecting commerce, to support its rule-making authority with regard to employee non-compete agreements. However, the FTC's jurisdiction under Section 5 is not unlimited – banks, federal credit unions, air carriers, common carriers, meatpackers, poultry dealers, and non-profit entities are exempt from coverage.

In addition to limitations on the FTC's rulemaking authority under the FTC Act, the dissenting member of the FTC identified two other grounds for possible legal challenge: (1) the FTC lacks clear Congressional authorization to issue the proposed rule under the "major questions doctrine," and (2) the FTC's action constitutes an impermissible delegation of legislative authority under the non-delegation doctrine.

In sum, it is exceedingly likely that any FTC final rule prohibiting the use of employee non-compete agreements will be tied up in legislation for years before it could become effective – if it survives.

Finally, courts are showing an unwillingness to enforce non-compete agreements in certain circumstances. In March 2022, the United States Court of Appeals for the Fifth Circuit affirmed a Louisiana federal district court's decision holding that a non-compete entered into one month before an employee's first day of employment was not enforceable. Louisiana's restrictive covenant statute provides that non-compete agreements may only be entered into between "persons in employee-employer relationships." Because the non-compete was entered into before the employee-employer relationship began, it was not enforceable. *See Rouses Enterprises, L.L.C., v. Clapp*, No. 21-30293, 2022 WL 686332 (5th Cir. Mar. 8, 2022).

Recommendations for Employers

For the present, employers in many states can still use non-compete agreements. However, they are under increasing scrutiny, and employers would be wise to review their agreements and evaluate their enforceability. Courts and governmental agencies

routinely decline to enforce non-compete agreements if they find them unreasonably broad. Employers should consider the following issues:

- **What is the business interest they are trying to protect?** Non-compete agreements, where allowed, must only be used to protect legitimate business interests, like trade secrets or commercially sensitive information, specialized training, company good will or client relationships. Employers should be able to identify and articulate the business interests that require the protection of a non-compete agreement.
- **Which employees really need to sign?** Employers should only use non-compete agreements with employees whose departure would actually pose a risk to the business interests protected. Courts and governmental agencies have invalidated non-compete agreements signed by front-line fast food workers and manufacturing employees, security guards and other similar types of employees because their departure from the company did not really threaten any legitimate business interest.
- **What is the law where you operate?** Restrictions on non-compete agreements vary from state to state. These restrictions generally limit things like the length of time an agreement can last and the types of employees with whom they can be used. Employers who operate in multiple states need to ensure that their non-compete agreements meet the requirements in each relevant state. A “one size fits all” agreement is unlikely to work for multi-state employers.

Employers should also consider whether they can protect their interests with other kinds of agreements. The identification of the business interests requiring protection is helpful here. For example, if the employers concern is trade secret or proprietary information, carefully drafted confidentiality or non-use/non-disclosure agreements will protect that information. If employers are trying to protect intellectual property or inventions, they can use employee inventions agreements. If the employer’s concern is customer relationships or “good will,” narrowly drafted non-solicitation agreements may protect those relationships. Non-disclosures agreements, inventions agreements and non-solicitation agreement are all viewed more favorably by courts and government agencies than non-compete agreements.