



ACC NRC: Non-Compete Agreements Update




June 11, 2024



What a law firm *should* be.



Speakers

			
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Agenda

- The FTC Final Rule
- Enforcement of the Final Rule
- Increasing State Law Regulation
- Protecting Your Company in a Post-Noncompete World



The FTC Non-Compete Clause Final Rule

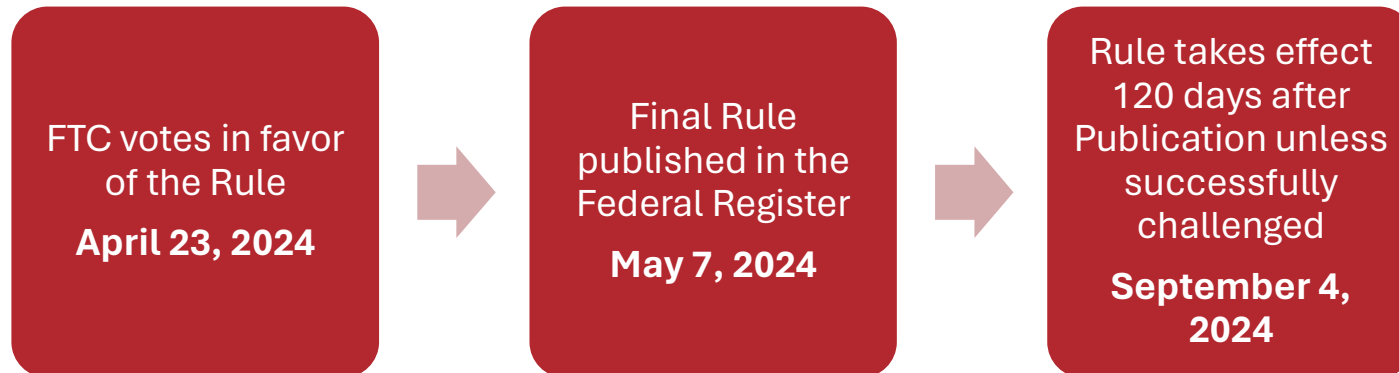


Current Status of FTC Final Rule

- Final Rule approved by the FTC on a 3-2 party line vote over strong dissent
- Final Rule does not take effect until 120 days after publication in the *Federal Register* – September 4, 2024
 - Does not apply to claims accruing prior to effective date.
- The Final Rule explicitly supersedes any state law authorizing conduct prohibited by Final Rule
- *Ryan, LLC v. Federal Trade Commission*, U.S. District Court for the Northern District of Texas
 - Briefing on preliminary injunctive relief closes on June 5, 2024
 - Ruling by July 3, 2024
- Bottom Line – **Stay Calm**



Timeline for Implementation



Ryan, LLC v. Federal Trade Commission

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS**

RYAN, LLC,

Plaintiff,

v.

FEDERAL TRADE COMMISSION,

Defendant.

Civil Action No. 3:24-cv-986-E

AMENDED COMPLAINT

Plaintiff Ryan, LLC, alleges as follows:

I. INTRODUCTION

1. The Federal Trade Commission has adopted a new rule outlawing the use of nearly all non-compete agreements by every employer, in every industry, across the entire United States (“Non-Compete Rule”). See Ex. A. According to the Commission, it has the authority to take this momentous step, which retroactively invalidates 30 million employment contracts and preempts the regulatory regimes of at least 46 States, because a provision of the Federal Trade Commission Act (“FTC Act”) that authorizes *procedural* rules supposedly also authorizes a sweeping *substantive* prohibition on “unfair methods of competition”—and because, the FTC maintains, non-competes are nearly always “unfair.” If ever a federal agency attempted to pull an elephant out of a mousehole, this is it. What’s more, the Non-Compete Rule rests on an open-ended statutory phrase—“unfair methods of competition”—that provides no intelligible principle to guide the agency or constrain its policy preferences, in violation of the Constitution’s restriction on the delegation of legislative powers. Perhaps unsurprisingly, this brazen power grab has been perpetrated by a politically unaccountable “independent” agency that is unconstitutionally



Ryan, LLC v. Federal Trade Commission

- Ryan, LLC filed suit against the FTC in the North District of Texas to challenge the rule. The U.S. Chamber of Commerce has intervened in this case.
- **The Plaintiffs in Ryan are challenging the rule on the following grounds:**
 - The FTC lacks authority under the FTC Act to issue substantive rules
 - The FTC lacks authority to ban non-competes by declaring them an unfair method of competition due to the major reach of that question
 - If the FTC Act is interpreted to allow the FTC to issue the rule, it would be an unconstitutional delegation of authority
 - The FTC's Commissioners lack constitutional authority to vote for the rule because their statutory removal protections are incompatible with the President's exercise of executive power
 - The FTC acted arbitrarily and capriciously in that the enforceability of non-competes should be determined on a case-by-case basis under the rule of reason because they can be a mutually beneficial term of employment
 - The FTC acted arbitrarily and capriciously in failing to sufficiently consider alternatives
 - By retroactively invalidating non-compete clauses without individualized consideration, the FTC failed to abide by the aims of the Fifth Amendment



FTC Final Rule Prohibitions

- Employers may not:
 - Enter into, or attempt to enter into, a **non-compete clause** with a **worker**
 - Enforce or attempt to enforce a non-compete clause
 - Represent to a **worker** that they are subject to a non-compete clause
- “Worker” includes paid and unpaid employees, independent contractors, externs, interns, volunteers, apprentices, or sole proprietors
- “Non-compete clause” means a term that prohibits, penalizes, or functions to prevent, a worker from seeking or accepting work or operating a business ***after*** the conclusion of employment



Not Covered By the FTC Final Rule

- Agreements between franchisors and franchisees
- Non-profit entities
- Common carriers
- Banks and savings and loan companies



Non-profit Exemption from the FTC's Rule

- Non-profit organizations are generally exempt from the FTC's jurisdiction
- **However**, some non-profit institutions claiming tax exemption may not be exempt from the FTC's rule
 - According to the FTC, tax-exemption is only “one factor to be considered,” but that factor does not “obviate the relevance of further inquiry into an organization's operations and goals.
 - The Commission will determine if the organization is “actually engaged in business for only charitable purposes” and whether the members or the organization derive profit.
 - **Healthcare industry** – The FTC suggests that the rule could apply to some of the 58% of hospitals that claim tax-exempt status as non-profits and 19% of hospitals that claim to be state or local government hospitals based on the factors besides purported tax-exempt status.



Exclusions from FTC Final Rule

SALE OF BUSINESS

- The Final Rule does not prohibit a non-compete clause entered pursuant to a **bona fide sale of a business entity**, of the **person's ownership** in a business entity, or **substantially all assets** of a business entity
- Removes the 25% ownership threshold from the Notice of Proposed Rulemaking
- Comments caution against “sham transactions” involving springing noncompetes, **repurchase rights**, **mandatory stock redemption programs**, or “similar evasions schemes”

SENIOR EXECUTIVES

- **Pre-existing** non-compete clauses involving **senior executives** are not prohibited
- Does not permit new agreements
- **Senior Executive** means:
 - Paid \$151,164 in annual comp
 - Works in a policy-making position
- Refers to entity's president, CEO or equivalent, or other person with final authority to make policy decisions that control significant aspects of the entity (as opposed to a subsidiary or affiliate)

LESSER RESTRICTIVE COVENANTS

- Does not prohibit employee or customer non-solicitation clauses, non-disclosure agreements, etc..., **BUT...**
- **“Functional Test”** to determine whether an agreement is a non-compete clause:
 - Agreements that effectively prohibit working in same field
 - Repayment clauses not reasonably related to employer costs
- Garden leave arrangements can still be used if the employee remains employed through the restriction period and is paid full compensation



FTC Final Rule Notice Requirements

- On or before the Final Rule's effective date (September 4, 2024), employers must provide clear and conspicuous notice to workers (including former employees) that their non-compete clause cannot and will not be enforced
- Notice can be provided in writing by hand delivery, mail, email, text message
- Group communications permitted
- Final Rule provides model notice language



Other Federal Law Attacks on Non-Competes

▪ **FTC Antitrust Enforcement Actions**

- Three settlements with employers for overbroad non-competes that restrict competition
- Prudential Security – security guards – 100-mile radius with \$100,000 liquidated damages
- O-I Glass – 1 year for entire USA
- Ardagh Group – 2 year for USA/Canada/Mexico



Other Federal Law Attacks on Non-Competes

▪ **National Labor Relations Board- General Counsel Memorandum 23-08**

- The memo seeks to prohibit the proffer, maintenance, and enforcement of non-compete agreement by employers as an unfair labor practice under the National Labor Relations Act (“NLRA”)
- The Memo claims that non-competes violate Section 7 of the NLRA by interfering with employees’ ability to:
 - concertedly threaten to resign to secure better working conditions;
 - carry out concerted threats to resign or otherwise concertedly resign to secure improved working conditions
 - concertedly seek or accept employment with a local competitor to obtain better working conditions
 - solicit their co-workers to go work for a local competitor as part of a broader course of protected concerted activity
 - seek employment, at least in part, to specifically engage in protected activity, including union organizing, with other workers at an employer’s workplace.
- To date, this interpretation has not been tested in enforcement or litigation proceedings



Enforcement of the FTC Rule

- The agency can pursue adjudication under Section 5(b) of the FTC Act or seek an injunction in federal court against a party that has engaged in an unfair method of competition under Section 13(b) of the FTC Act
 - The FTC may also seek an injunction if an employer violates the Rule if the injunction is in the public interest
 - The FTC **may not be able** to obtain monetary relief for violations of the rule under the current state of the law
 - Section 19 of the FTC Act allows the FTC to seek monetary relief for violations of consumer protection rules on unfair or deceptive practices, but Section 19 does not provide remedies for unfair methods of competition
 - The FTC cannot obtain civil penalties or other monetary relief unless an employer violates an Order



State Law Restrictions on Non-Competes



The State Law Legal Landscape

IF THE FTC RULE TAKES EFFECT

- FTC Final Rule will prohibit non-compete clauses and conflicting state laws preempted
- State laws will continue to govern non-solicitation and non-disclosure agreements

IF THE FTC RULE IS INVALIDATED

- State laws remain the primary source of regulation of all restrictive covenants

RECENT DEVELOPMENTS AT THE STATE LEVEL

- States, including DC, Maryland, and Virginia, have imposed increasing regulation on employer use of non-competes and other restrictive covenants
- These laws include:
 - Outright prohibitions
 - Salary restrictions
 - Notice requirements
 - Employer penalties for invalid agreements



D.C., Maryland, and Virginia Non-Compete Laws

WASHINGTON, D.C.

- Non-compete clauses permitted only for highly compensated employees – over \$150,000, \$250,000 for doctors
- Applies to employees who spend 50% or more time in D.C., or spend a substantial amount of time in D.C. and not 50% in any other state
- Maximum restriction term is 1 year (2 years for doctors)
- Agreement must be provided to employee 14 days in advance
- Limits use of moonlighting policies
- Does not apply to NDAs, non-solicitation not addressed but likely inapplicable

MARYLAND

- Prohibits non-compete and conflict of interest provisions for health care providers earning less than \$350,000, and veterinary professionals
- Non-competes prohibited against other employees earning less than \$46,800
- For health care providers, non-compete terms limited to 1 year and 10 mile radius of primary place of employment

VIRGINIA

- Non-compete clauses prohibited for employees earning less than \$73,320
 - Exception for employees whose earnings derive in whole or predominant part from commissions
- Penalty of \$10,000 per violation
- In addition to statute, Virginia common law is not favorable to enforcement of restrictive covenants



Other Recent State Non-Compete Laws

MINNESOTA

- Prohibits enforcement of non-compete agreements entered after July 1, 2023, other than in connection with sale of business
- Does not include non-disclosure agreements or non-solicitation agreements
- Prohibits non-Minnesota choice of law and venue provisions for residents

CALIFORNIA

- Prohibits non-compete and employee and customer non-solicitation agreements in most circumstances
- Recent law purports to extend California prohibition to contracts regardless of whether contract was signed and employment maintained outside of California
 - E.g. – employee hired in D.C. with valid non-compete, moves to California and claims agreement is unenforceable
- Requirement to notify current and former employees of non-compete invalidity (deadline has passed)
- \$2,500 penalty per violation

ILLINOIS

- Prohibits non-compete agreements for employees earning less than \$75,000, and non-solicitation agreements for employees earning less than \$45,000
- If only consideration is employment or continued employment, the agreement is unenforceable unless the employee works for 2 years – even if they quit
- Employer must provide 14 day notice and consideration period



More Recent State Non-Compete Laws

MASSACHUSETTS

- Prohibits enforcement of non-compete agreements against, among others, non-exempt employees and employees terminated without cause
- Non-compete terms limited to 1 year and the geographic area where the employee worked, had material presence or influence
- Must be supported by garden leave or other independent consideration
- Agreement must be provided to employee 10 business days in advance
- Limits on venue and choice of law provisions

NEW YORK

- Legislation passed in 2023 that would have prohibited all non-compete agreements
 - Bill was not signed by Governor
- Indications that bill may be reintroduced with an income threshold (likely \$250,000-\$300,000)
- Measure introduced (not yet passed) in New York City to prohibit enforcement of existing and future non-compete agreements

DELAWARE

- No legislation, but troubling shifts in case law
- *Kodiak Building Partners, LLC v. Adams*, (Del. Ch. Oct. 6, 2022): Refused to blue pencil non-compete because it prohibited the seller from competing in territories in which the seller had not operated
- *Ainslie v. Cantor Fitzgerald, L.P.*, (Del. Ch. Jan. 4, 2023): Found a forfeiture-for-competition provision in a limited-partnership agreement unenforceable
- *Intertek Testing Services NA, Inc. v. Eastman*, (Del. Ch. Mar. 16, 2023): Refused to blue pencil overbroad global non-compete



Other State Salary Thresholds for Non-Competes

- Colorado:
 - Non-compete: \$123,750
 - Non-solicitation: \$74,250
- Maine:
 - 400% of federal poverty level (approx. \$58,320)
- Oregon:
 - \$108,575.64
- Rhode Island:
 - 250% of federal poverty level (approx. \$36,450)
 - Also not enforceable against non-exempt employees
- Washington:
 - \$116,593.18



Challenges of a Remote Workforce

- Where are employees working?
- Where are employees living?
- What choice of law in agreements?
- How does applicable state law affect choice of law?



Non-Compete Drafting Considerations in Light of Patchwork State Laws

- Consider which employees need the full suite of restrictive covenants to avoid perceived overreaching
 - Use of a tiered approach – non-disclosure (appropriate for most), non-solicitation of employees, IP assignment, non-solicitation of customers, non-compete
- State laws invalidating choice of law and venue provisions are making the one-size-fits-all approach more difficult
- Specificity is always better
 - Identify specific items in defining Confidential Information, over general categories
 - Identify the specific scope of prohibited business or activities in non-compete/non-solicitation clauses, over generic language like “substantially similar products or services”
 - If appropriate, can tie the restriction to specific competitors
- Tactics for rolling out new agreements to existing employees



Protecting Your Company's Business in a Post Non-Compete World

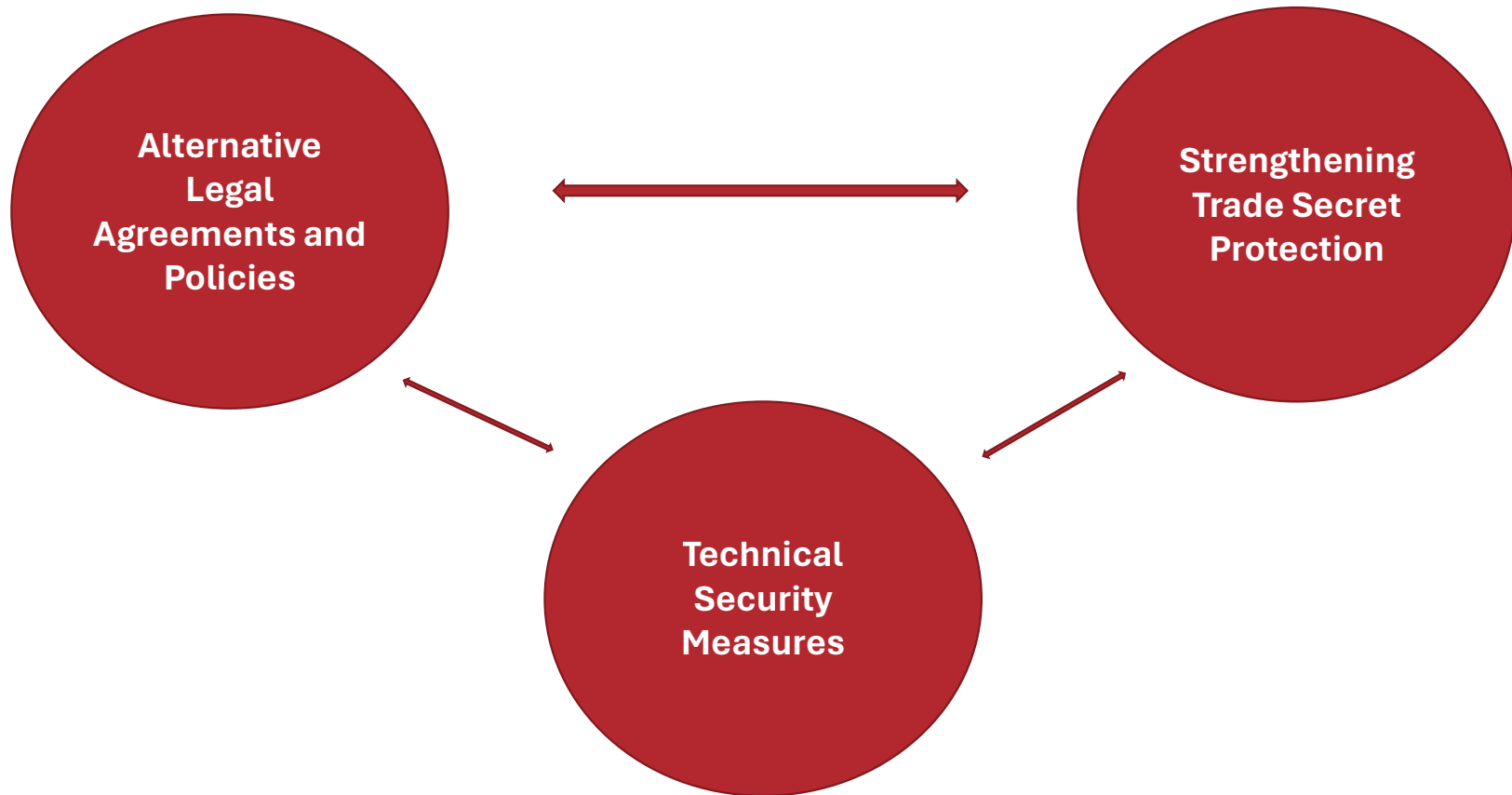


What Does a Post Non-Compete World Look Like?

- Flash forward to an unknown time in the future, when the U.S. Supreme Court (or the Northern District of Texas or Fifth Circuit), rules that the FTC Final Rule is a valid exercise of agency power.
- Consequences of this scenario:
 - New non-compete agreements are no longer enforceable
 - Existing non-compete agreements only enforceable against limited class of “senior executives”
 - Ability to restrict solicitation of customers and employees governed primarily by state law
 - Protection for statutory trade secrets and through non-disclosure agreements



Protecting Competitive Advantage Without Non Competes



Alternative Legal Protections

- Non-solicitation and non-disclosure clauses where appropriate and enforceable
- Employee acknowledgments of company's ownership of competitive information
- Confidentiality and conflict of interest policies
- Policies around information security and safeguards



Strengthening Trade Secret Protections

- Trade secret means essentially any type of information if:
 - The owner of the information has taken reasonable measures to keep such information secret; and
 - The information derives independent economic value, actual or potential, from not being generally known or readily ascertainable to another person who can obtain economic value from the disclosure or use of the information.
- Surprisingly difficult question in some cases – **What are your trade secrets?**
 - What is the secret sauce that gives your company an advantage over a competitor providing similar products or services?
- Audit competitive information that is potential trade secret material:
 - What is it? Identify, describe, and document processes and methods alleged to be trade secrets
 - Who has access to the information?
 - How it is being protected?



Security Safeguards

- Necessary to meet the “reasonable efforts” of secrecy requirement for trade secret protection
- Competitive information (sales, R&D) accessible only by employees with a need to access
 - *i.e.*, non-manager access to customer information limited to customers a particular employee services
- Reconsider BYOD policies and use of personal devices and accounts for business purposes
- How is data emailed or downloaded out of your systems?



A Note on the Blurred Lines

- The FTC Rule does not explicitly ban non-disclosure agreements or non-solicitation agreements, BUT....
 - The FTC takes the position that restrictive covenants may functionally operate as non-competes. In that case, they would be banned by the Rule
 - Under the Final Rule, non-disclosure clauses operate as non-compete clauses “where they span such a large scope of information that they function to prevent workers from seeking or accepting other work or starting a business after they leave their job.”
 - The Commission also concluded that non-solicitation clauses can operate as non-compete clauses “where they function to prevent a worker from seeking or accepting other work or starting a business after their employment ends.”



