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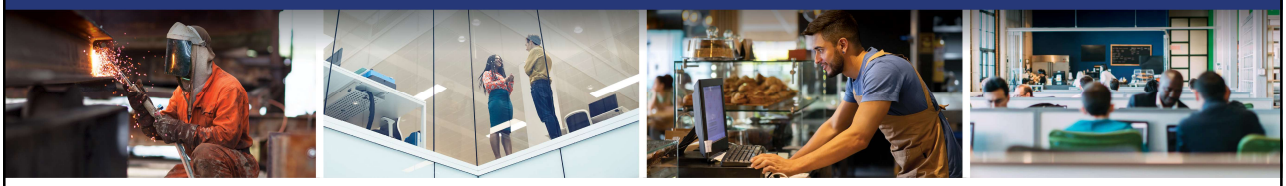

Are Non-Competes Dead, Alive, or on Life Support?
Where Non-Compete and Other Restrictive Covenants Stand in Light of the FTC's Final Rule Injunction

Presented by: Jason Tremblay, Esq. and Alexander Reich, Esq.

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Overview

- Jason is a business attorney and litigator who advises companies in a wide range of industries on employment law and commercial matters.
- His experience includes counseling, negotiation and litigation on issues critical to the evolving workplace including wage and hour disputes, restrictive covenant matters, and federal, state and local statutory claims.
- Jason provides clients with an array of services including drafting and negotiating employment and independent contractor agreements and responding to governmental audits and investigations.
- **Degrees**
  - J.D., Chicago-Kent College of Law, *Order of the Coif*
  - B.A., Franklin and Marshall College
  - University of Aberdeen, Scotland

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Overview

- Alexander is a trusted litigator and advisor who focuses on employment law across a variety of sectors.
- Clients look to him for counsel on matters involving federal and state statutes such as Title VII, the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA) and the Family and Medical Leave Act (FMLA).
- Alex regularly drafts employment agreements and litigates issues relating to restrictive covenants and trade secrets.
- He also defends employers in cases ranging from single employee discrimination claims to class action wage and hour matters.
- **Degrees**
  - J.D., cum laude, Chicago-Kent College of Law
  - B.A., University of Michigan

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Introduction and Agenda

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Introduction

- Courts dislike non-competes and other restrictive covenants.
- They contradict ideals of capitalism and free market economy.
- They are often viewed as a restraint of trade, although if properly drafted will be enforceable as part of an agreed upon contractual exchange.
- What courts hate more than non-competes are people who steal.
- Most litigation is caused by employees and new employers making stupid mistakes (the “need/greed” factor).

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Agenda

- Update on the FTC Final Rule Injunction
- Where Do the NLRB and Other Agencies Currently Stand on Restrictive Covenants?
- Where Do States Currently Stand on Restrictive Covenants?
- How to Maintain Competitive Advantage in Light of Evolving Laws?

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Update on FTC Final Rule Injunction

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FTC Non-Compete Ban Injunction - Background

- On Jan. 5, 2023, FTC issued NPRM banning businesses from using non-compete clauses.
- Multiple justifications for proposed rule but primarily based on belief that non-competes stifle competition and employee mobility, thus negatively impacting pay, benefits, and working conditions.
- Proposed ban was wide sweeping and included "non-competes" and anything that is a *de facto* non-compete clause–employees and contractors.
- On April 23, 2024, after 27,000+ comments, FTC voted to finalize the Final Rule that largely adopted the language in the NPRM (published on 5/7/24).

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FTC Non-Compete Ban Injunction - Background

- Within hours of FTC voting to approve the Final Rule, the first lawsuit was filed in N.D. Texas (*Ryan, LLC v. FTC*), seeking to enjoin the Final Rule.
- A day later, the US Chamber of Commerce filed a similar lawsuit in the E.D. Texas (*Chamber of Commerce, et al. v. FTC*).
- A third lawsuit (*ATS Tree Services LLC v. FTC*) was filed in the E.D. Pa. the next day.
- The *Chamber of Commerce* and *Ryan* cases in Texas were consolidated because they were seeking the same relief – to stop the FTC from enforcing the Final Rule.

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FTC Non-Compete Ban Injunction - Ruling

- On July 3, 2024, the *Ryan* court entered a preliminary order prohibiting the FTC from enforcing the Final Rule until a ruling on the merits (but only as to the named plaintiffs).
- On July 23, 2024, the E.D. Pa. in the *ATS Tree Services* case denied the plaintiff's preliminary injunction motion to enjoin the FTC's Final Rule (the plaintiff has since voluntarily dismissed the lawsuit).
- On August 20, 2024, the *Ryan* court issued the first summary judgment decision on the merits enjoining the FTC Final Rule.
- The *Ryan* court based its decision on 2 primary arguments:
  - The FTC does not have the statutory authority to issue rules defining unfair methods of competition; and
  - The FTC's actions were arbitrary and capricious.

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FTC Non-Compete Ban Injunction – Where Do Things Stand Now?

- The FTC appealed the *Ryan* ruling to the Fifth Circuit Court of Appeals on October 18th.
- The *Ryan* ruling does not prevent the FTC from addressing non-compete cases on a case-by-case basis, which they have indicated they will do.
- The decision and discussion has brought significant attention to the issue of non-competes that has and will continue to trickle down to state legislatures as they weigh similar rules and laws.
- The *Ryan* ruling does not impact other agencies such as the NLRB which has its own rules and statutory authority.

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Where Do the NLRB and Other Agencies Currently Stand on Non-Compete Agreements?

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NLRB and Non-Competes

- May 30, 2023, NLRB GC (Jennifer Abruzzo) memo stating that non-competes are unenforceable under NLRA.
- Justification is that non-competes chill Sec. 7 rights.
- Discourage employees from threatening to resign or resigning in order to obtain better working conditions. Also restrict employees from soliciting others to work elsewhere.
- GC contemplates some exceptions and not all non-competes violate the NLRA (e.g., true managers, true ICs, etc.).
- Not "the law" but the GC's interpretation of the law, which will need to be interpreted by Regional Directors.

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NLRB and Non-Competes

- October 7, 2024 NLRB GC memo:
  - Remedying the Harmful Effects of Non-Compete and "Stay-or-Pay" Provisions that Violate the National Labor Relations Act
- Argues that non-competes are "self-enforcing" because employees forgo opportunities out of fear of breaching.
- Where the NLRB finds an employer maintained an unlawful non-compete, rescission alone will fail to remedy all the harms and employers should pay difference between opportunity and current pay.
- Urges NLRB to find that ***any provision*** under which an employee must pay their employer if they separate from employment, whether voluntarily or involuntarily, within a certain timeframe is ***presumptively*** unlawful.

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J.O. Mory Inc.

- On June 13, 2024, an NLRB ALJ held that overly broad restrictive covenants unlawfully restricted employees' Section 7 rights.
- Company was a non-unionized contracting business that unknowingly hired a "salt" who signed an agreement with covenants.
- After employee was terminated for lying on employment application, the union filed 2 NLRB Charges alleging ULPs.
- ALJ found 3 covenants problematic:
  - Non-solicit that prohibited EEs from encouraging others to leave company.
  - Non-compete that restricted EEs from working for "similar or competitive" companies in any manner.
  - Request for EEs to report all outside job offers.

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The DOJ is getting involved too…

Mizell, et al. v. UPMC

- Workers from the University of Pittsburgh Medical Center filed proposed class action.
- UPMC acquired numerous hospitals becoming largest non-government employer in PA.
- Then imposed anti-competitive policies, including non-competes, non-solicits, and "system wide do-not-rehire blacklist."
- DOJ filed Statement of Interest on September 30, 2024.
  - Both the non-compete restrictions and no-rehire policy disincentivize workers from considering jobs elsewhere.
  - Taken as a whole the complaint plausibly pleads that they are part of an "overarching anticompetitive scheme."

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States with Restrictive Covenant Restrictions

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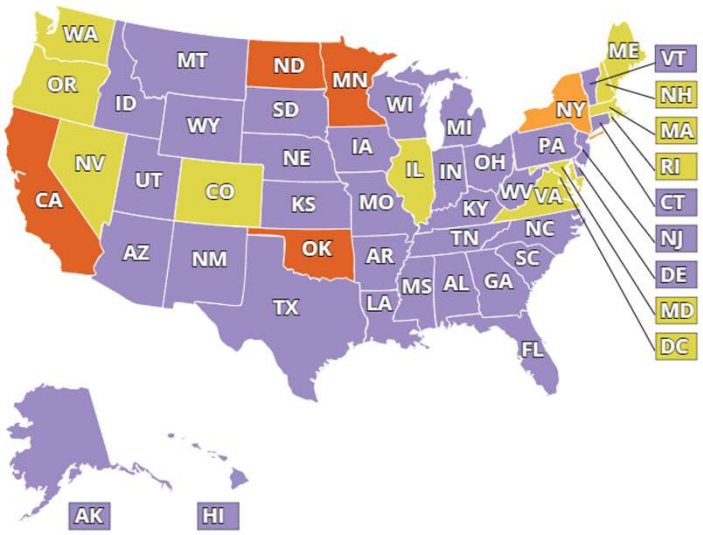

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Massachusetts

- **Massachusetts Noncompetition Agreement Act (MNAA)**
- Effective October 1, 2018
- Notice requirement
  - 10 days before effective date of agreement
  - Right to consult with attorney
- Garden leave requirement
- 1 year max, but 2 years if the employee breached fiduciary duty or stole property.
- Employer may not enforce if employee was:
  - nonexempt
  - terminated without cause
  - laid off

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Illinois

Illinois Freedom to Work Act, 820 ILCS 90

- Effective January 1, 2022
- Consideration
  - 2 years of employment; or
  - Additional benefits
- Notice requirement
  - 14 days before effective date of agreement
  - Right to consult with attorney
- Compensation thresholds (current)
  - Non-compete: $75,000; Non-solicit: $45,000
  - Escalates every 5 years

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Minnesota

Minn. Stat. § 181.988

- Bans non-competes entered on or after July 1, 2023.
- Defines “employee” to include independent contractors.
- Prohibits application of another jurisdiction’s choice of law or choice of venue.

Exceptions:

- Excludes confidentiality, moonlighting, and non-solicits.
- Does not apply to sale of a business.

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Washington D.C.

Non-Compete Clarification Amendment Act of 2022

- Voids non-competes entered on or after October 1, 2022.
- Does not apply to "highly compensated employee."
  - Currently $154,200 or, if the employee is a medical specialist, $257,000.
  - 14-day notice period and specific text.
  - Must state:
    - The functional scope of the restriction (i.e., services, roles, industry, or competing entities);
    - The geographic scope of the restriction; and
    - The term of the restriction - cannot exceed 365 days separation (or 730 days if the employee is a medical specialist).

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Maryland

- Effective 1/1/24, bans non-competes with employees earning equal or less than 150% the state min. wage ($46,800 annually)
- Effective 6/1/24, bans non-competes for licensed veterinary practitioners
- Effective 7/1/25, bans non-competes for licensed healthcare workers providing direct patient care, earning $350,000 or less
  - Otherwise, 1 year and 10 mile max

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California

- SB 699 (eff. 1/1/24) prohibits employers from attempting to enter into or enforce a non-compete regardless of where the contract is signed – whether inside or outside of CA.
  - Arguably CA's attempt to "export its ban" across the country.
  - *But other states have not enforced.*
    - First Circuit decision in *DraftKings/Hermalyn* case
    - Covenant signed in Boston with MA law.
    - Executive leaves for competitor and moves to CA, and files a declaratory judgment action in CA.
    - DraftKings sues in MA.
    - Does CA policy overtake MA law when a MA business contracted with an originally-based MA employee and selected MA as the governing law?
    - 1st Circuit court did not give much weight to CA law.

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California

- AB 1076 (eff. 1/1/24) voids any employment non-compete "no matter how narrowly tailored."
- Codified CA case rejecting 9th Circuit "narrow restraint" exception
- Notice requirement for all CA workers employed after 1/1/22 who signed a non-compete.
- Must inform them that the provisions are void in CA.
- Notice had to be issued by 2/14/24.
- Now ILLEGAL to include non-competes (not just void).

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New York

- **NY State Senate Bill 2023-S3100A**

VETOED

- Passed New York Legislature on June 20, 2023.
- No employer would be allowed to "seek, require, demand or accept" a non-compete agreement from any covered individual.
- The bill would void every contract to the extent "anyone is restrained from engaging in a lawful profession, trade, or business of any kind[.]"
- On December 23, 2023, Gov. Hochul vetoed the bill but expressed that she would support a non-compete ban for lower wage earners, so more limited legislation is expected.

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New York City

- Proposed 2/28/24
- Would prohibit employer from maintaining, entering into, or attempting to enter into a non-compete with a "worker."
  - Includes contractors
  - Includes "effective" non-competes (like overbroad non-solicit)
- Requires recisions of existing non-competes.
- No exceptions.

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How to Maintain Your Competitive Advantage in Light of Evolving Laws

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Tip #1: You Likely Don't Have to Scrap Your Current Agreements

- Take a breath and get some solace in knowing that, currently, all of your non-competes are not deemed to be unenforceable by the FTC and that you do not have to send out notices to current and former employees.
- But, remember the Texas federal court decision does not prohibit the FTC from taking on individual cases and deeming non-competes unenforceable on a case-by-case basis.
- Don't forget about the NLRB and DOJ either!
- As such, attention still needs to be paid to this issue.

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Tip #2: Take Inventory of Existing Restrictive Covenants

- The law on enforceability of restrictive covenants is constantly evolving (and becoming local).
- Regularly review state law updates to ensure existing restrictions are still enforceable.
- Take inventory of whether the company needs a non-compete, non-solicit or non-disclosure, all of them or none of them.
- What is truly necessary to protect your competitive advantage?
  - Elicit input from different departments and groups.
- Remember that "one size does not fit all."

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Tip #3: Narrow/Update Non-Competes

- Notwithstanding the decision in *Ryan*, it is clear that non-competes (and other restrictive covenants) are under attack at the federal and state level.
- Evaluate whether the restrictions are narrowly tailored to protect a legitimate business interest.
- Do all employees or just high-level employees need to sign them?
- If you do update a non-compete, remember that, in most states, fresh consideration must be given for that new non-compete (even if less broad and more narrowly tailored).

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Tip #4: Bolster/Update Non-Solicits

- While certainly still under scrutiny and subject to the same standards as non-competes, non-solicits are generally easier to enforce.
- Companies are truly injured/harmed when their clients, employees, and other relationships go elsewhere.
- Prioritize non-solicit provisions over non-compete provisions.
- Beware: They must still be narrowly tailored (e.g., "all customers of the company" versus "those customers serviced by the employee within the past year").

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Tip #5: Get Trade Secrets House in Order

- While non-competes and non-solicits have been under attack, most state legislation and other rules carve out the misappropriation of trade secrets.
- Courts do NOT like employees stealing confidential information.
- Employers should identify what is truly a trade secret (don't forget applicable definition of a trade secret) and ensure that proper steps are taken to secure and/or limit access to such trade secrets.
- Enact policies geared towards protection of trade secrets and confidential information.

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Tip #6: Bolster NDA/Confidentiality Provisions

- Understand that not everything is a trade secret or confidential—so don't say it is in your agreement.
- Once you evaluate what is a trade secret and/or confidential, ensure that such categories are specifically included in any NDA or confidentiality provision.
- Many courts are not deeming the "laundry list" of categories of documents as "confidential" because they are overly broad and unenforceable.
- What is confidential or trade secret?

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Tip #7: Don't Forget About the DTSA

- Trade secret misappropriation law has been incorporated into federal law under the Defend Trade Secrets Act of 2016.
- Enables employers to file trade secret misappropriation claims in federal court (which may be more favorable).
- Elements are similar to uniform trade secret laws.
- Proof of misappropriation allows the plaintiff to obtain attorneys' fees and double damages if the appropriate whistleblower/confidentiality notice exceptions are included in the agreement.
- Proper compliance with DTSA gives employers more options.

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Tip #8 – Don't Forget About the Inevitable Disclosure Rule

- May provide a common law remedy in some jurisdictions.
- May also apply with respect to high level employees with agreements.
- Applies in circumstances where former employee is engaged in capacity in which he or she inevitably would use or disclose prior employer's trade secrets in performance of their new job.

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Tip #9: Don't Underestimate the Importance of Other Contract Provisions

- Jurisdiction and Choice of Law provisions can be outcome determinative so don't overlook them (especially as state law evolves) – remember the *DraftKings* case.
- Don't forget (or rely upon) a blue pencil provision, but understand there are many jurisdictions that don't allow or restrict applicability of blue penciling.
- Beware of one-sided attorney's fee shifting provisions.
- Ensure any mandatory arbitration provision properly carves out injunctive cases of this nature.
- Don't forget about assignability clause.

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Tip #10: Implement Electronic Monitoring and Security Measures

- Since business is almost all electronic, extra measures must be taken to implement reasonable security measures.
  - Restriction of access to certain files and directories.
  - Implementation of commercially reasonable password and access restrictions.
  - Reduce/eliminate the use of flash drives and Dropbox accounts.
  - Implement a system whereby employees' remote or other access is tracked and recorded.
  - Install software that allows for remote wiping.

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Tip #11: Don't Forget About Duty of Loyalty

- Generally, higher level employees have a duty of loyalty, which means:
  - Act solely for the benefit of employer.
  - Avoid all conflicts between duty to employer and self interest.
  - Exert best efforts for employer.
  - Not compete with employer while employed.
  - Not misappropriate confidential information and trade secrets.
  - Not solicit employer's customers or employees prior to end of employment.
  - Not usurp/divert employer's business opportunities.

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Tip #12: Consider Potential Drawbacks in Suing to Enforce Restrictive Covenants

- Seeking and obtaining immediate injunctive relief in court is difficult and a high standard to meet.
- Courts are very hesitant to force employees to sit on the sidelines in the first place.
- An unfavorable ruling or a finding that a covenant is likely not enforceable on a TRO (while not final) can open up the floodgates to other employees wanting to leave (or arguing their restrictions are unenforceable).
- Fully vet the factual record supporting the injunction.
- Some states provide for attorney's fees for the employees if the employer sues but loses.

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Concluding Points

- Non-competes are certainly not dead (at least in most states) but probably somewhere between alive and on life support.
- One size does not fit all – restrictive covenants should really be tailored to the background facts and circumstances.
- Restrictive covenant law is evolving and we anticipate: (1) federal action – either through legislation or otherwise – will continue to chip away at non-competes, and (2) more states (and cities) will pass legislation to impact the enforceability of non-competes.
- Work with your counsel and explore other provisions and measures to protect your competitive advantage.

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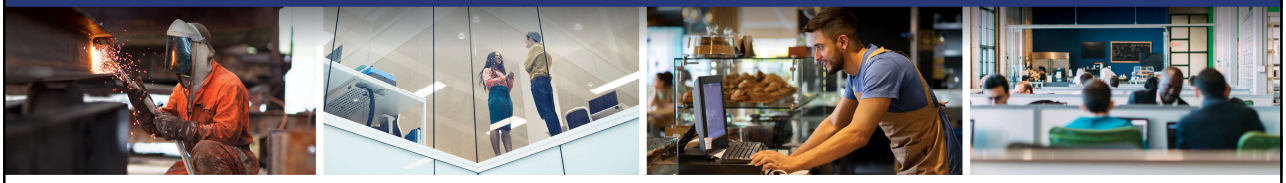

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