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The Biden Administration's One-Two Punch on Employee Non-Competes—The Current State of Affairs

On July 9, 2021, President Biden issued an Executive Order on Promoting Competition in the American Economy, which noted some employers require workers to sign non-compete agreements that "may unduly limit workers' ability to change jobs." The President encouraged the Federal Trade Commission ("FTC") to exercise its rulemaking authority to diminish the unfair use of non-compete clauses that may "limit worker mobility."

On January 5, 2022, the FTC published a Notice of Proposed Rulemaking (the "Proposed Rule"), which would preclude employers from entering into non-compete agreements with employees. It also would render unenforceable all previously entered non-compete agreements.

Background

Non-compete clauses are one type of restrictive covenant in which an employee agrees not to compete with their employer once the employment relationship ends. Historically, state law has governed the enforceability and the allowable scope of restrictive covenants, including non-competes. Broadly speaking, restrictive covenants typically are enforceable only if they are reasonable in both time and geographical scope, and if they are narrowly tailored in restricting the employee's future employment only to the extent necessary to protect legitimate employer interests in, among other things, customer goodwill and confidential information.

Currently, the states of California, Nebraska, North Dakota and Oklahoma have a near-complete ban on non-compete restrictions, while other states restrict the use of non-competes in various ways. In addition, over the past several years, more than a dozen states and Washington, D.C. have imposed certain statutory requirements that employers must satisfy to enforce non-competes. These requirements often include a minimum compensation level as well as notification obligations. See, for instance, our prior Client Alert regarding Colorado's new restrictions on non-compete agreements. The FTC's Proposed Rule would further complicate this already difficult area of the law.

FTC's Enforcement Actions Against Non-Competes

On January 4, 2023, just one day before issuing the Proposed Rule, the FTC announced administrative actions against several companies and their executives for utilizing non-compete agreements as stratagems to restrain workers and restrict competition. These companies included Prudential Security, O-I Glass and Ardagh Group.

The FTC required Prudential Security to cancel and void approximately 1,500 non-compete agreements it had imposed on low-wage employees working as security guards, which were the majority of Prudential Security's workforce. Prudential Security's non-compete agreements barred its employees from working within a 100-mile radius of their job sites for two years after leaving Prudential Security. Prudential Security's use of its non-competes, the FTC said, deprived its "former employees of the benefits of competition, leaving them with lower wages, less favorable working conditions, and increased economic uncertainty."

The FTC also targeted non-competes issued by two glass container manufacturers, O-I Glass and Ardagh Group, which the FTC argued "locked up highly specialized workers, tending to impede the entry and expansion of rivals." By enforcing the more than 1,700 combined non-competes, the FTC found these employers had unfairly inhibited other glass manufacturers from finding skilled labor. The FTC prohibited both O-I Glass and Ardagh Group from enforcing their non-compete agreements against their employees.

The FTC's Chair noted in a statement that the FTC's actions in these cases "should put companies and the executives that run them on notice that using non-competes to restrain workers and restrict competition invites legal scrutiny."

The FTC's Proposed Rule To Ban Non-Compete Clauses

If the FTC's Proposed Rule becomes final, it will prohibit employers from entering into explicit and de facto non-compete clauses with employees. A non-compete clause would be invalid if it has "the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer." Additionally, the Proposed Rule applies not only to employees, but also to independent contractors, externs, interns, volunteers, apprentices and sole proprietors offering services to the company's clients or customers.

Under the Proposed Rule, employers would be required to rescind existing non-compete clauses within 180 days following publication of the final rule. Additionally, employers would need to provide notice to workers that their non-compete clauses are no longer enforceable within 45 days after rescission. The Proposed Rule provides model language for such notice.

Although the FTC noted that "Congress intended the federal antitrust laws to supplement, not displace, state antitrust remedies," the Proposed Rule banning non-competes contains a provision expressly preempting state law. Under the FTC's Proposed Rule, any state law that is inconsistent with the Proposed Rule by, for instance, allowing non-compete agreements against key employees would be preempted. The Proposed Rule, therefore, would "supersede any state statute, regulation, order, or interpretation to the extent that such statute, regulation, order, or interpretation is inconsistent with the" Proposed Rule. State laws regarding other kinds of restrictive covenants, such as customer non-solicitations, would presumably remain in effect.

The FTC has carved out a few exceptions from the Proposed Rule. For example, non-compete clauses would be permitted to apply to employee-owners in connection with the sale of a business. Even non-compete agreements in that context, however, would be permitted only where the restricted party is an owner, member or partner holding at least a 25% ownership interest in the business entity that is (or whose interests are) being sold.

Additionally, the definition of "non-compete clause" in the Proposed Rule does not include traditional non-disclosure agreements or client/customer non-solicitation agreements, which would continue to be governed according to existing state law. The Proposed Rule, however, indicates that such covenants, as well as covenants requiring repayment of excessive training costs upon early termination of employment, could function as de facto non-compete clauses if "they are so unusually broad in scope that they function as such." Under the Proposed Rule, a challenged clause or covenant would be reviewed based on its function rather than its name.

FTC Public Forum Held on February 16, 2023

On February 16, 2023, the FTC hosted a public forum to examine the Proposed Rule and address public comments. The agenda included an opening statement from the FTC Chair, an overview of the Proposed Rule and the rulemaking process, a panel discussion of speakers, and public comment to the Proposed Rule.

The FTC fielded public comments from diverse industry groups, including business owners, franchises, members of the health care community and other various associations. Those in support of the Proposed Rule expressed the frustrating effects of non-competes, such as lack of mobility, depressed wages, poor working conditions and higher health care costs.

Critics, on the other hand, generally argued the Proposed Rule is overly broad and the FTC lacked the requisite congressional authority to promulgate the Proposed Rule. Opponents also expressed concern over the ability to prevent high-level executive employees from using trade secret knowledge gleaned from their businesses against them after termination.

At the close of the public forum, one FTC Commissioner emphasized the positive impact the Proposed Rule would have on various types of employees: "Non-competes are not just a problem for blue collar workers . . . they are also imposed on high wage earners."

Commissioner Christine Wilson's Resignation and the House Judiciary Committee's Letter

On February 14, 2023, FTC Commissioner Christine Wilson announced her resignation from the FTC. Commissioner Wilson was the sole dissenter to the Proposed Rule and vehemently disagreed with the FTC Chair's vision to ban non-competes. In her words, Commissioner Wilson stated that the FTC Chair's recent actions demonstrated a "disregard for the rule of law and due process." As noted in her dissent, Commissioner Wilson opined that the FTC lacked experience enforcing non-compete agreements, and she noted that the lack of economic mobility cited by the Proposed Rule's supporters failed to causally demonstrate harm to consumers and competition. In her closing, Commissioner Wilson stated, "[w]e all know the simple rule: If you see something, say something. Consider this my noisy exit." It is unclear what impact, if any, Commissioner Wilson's "noisy exit" may have on the Proposed Rule.

What is clear, however, is that there is an increasingly vocal opposition to the Proposed Rule. For example, on the day Commissioner Wilson resigned, the U.S. House Judiciary Committee addressed a letter to the FTC Chair and her fellow Commissioners. House Judiciary members referred to the Proposed Rule as a "power grab" and "the latest example of the Biden FTC straying from the Commission's mandate in its eagerness to centrally plan the American economy to meet a preferred social agenda." The letter also echoed Commissioner Wilson's opinion that the FTC exceeded its congressional authority in promulgating the Proposed Rule—one of several legal challenges the Proposed Rule will face if finalized.

The Workforce Mobility Act of 2023

On February 1, 2023, roughly one month after the FTC introduced its Proposed Rule, a bipartisan group of U.S. Senators reintroduced the Workforce Mobility Act (the "Act") in Congress. The Act was previously introduced in 2018, 2019 and 2021, but was stalled each time.

Like the FTC's Proposed Rule, the Act seeks to ban the enforcement of non-competes nationwide. The proposed Act provides, in pertinent part, that "no person shall enter into, enforce, or attempt to enforce a non-compete agreement with any individual who is employed by, or performs work under contract with, such person with respect to the activities of such person in or affecting commerce. Such agreements will have no force or effect."

The Act states that the recent increase in non-compete agreements in America "is contrary to the commitment of Congress to foster stronger wage growth for workers in the United States." Enforceable

non-competes, the Act continues, "also reduce wages, restrict worker mobility, impinge on the freedom of a worker to maximize labor market potential, and slow the pace of innovation in the United States."

The Act contains similar, although not identical, exceptions to those incorporated into the FTC's Proposed Rule. For example, under the Act, non-compete agreements still would be permitted in the context of the sale of goodwill or ownership interests in a business.

Although the FTC's Proposed Rule and the Act are strikingly similar, they do have a few notable differences. Primarily, the Act would not apply to non-compete agreements entered into before its enactment, whereas the FTC's Proposed Rule would apply to such agreements. Additionally, because the FTC is a federal agency, it cannot act unless Congress has delegated the authority for it to do so. Not only does the Act expressly authorize the FTC to bring actions against employers in violation of the Act, but it also authorizes the Department of Labor and state Attorneys General to do the same.

The Act also grants employees subject to non-compete agreements a private civil right of action and permits recovery of "any actual damages sustained by the individual as a result of the violation; and in the case of any successful action, the costs of the action and reasonable attorney's fees, as determined by the court." The Act specifically provides that claims brought under the Act would not be subject to arbitration and joint-action waivers, including waivers of joint, class and collective actions.

If passed, employers with employees in or affecting commerce would be required to post notice of the provisions of the Act in a conspicuous place where notices to employees and applicants for employment are customarily posted physically or electronically.

What's Next?

The Proposed Rule is not final and has not taken effect. The FTC is accepting public comment about the Proposed Rule for 60 days, or until March 20, 2023. The FTC has indicated an interest in comment on other versions of the Proposed Rule, including:

- Whether the Proposed Rule should be a categorical ban or a rebuttable presumption of illegality;
- Whether different categories of workers should be subject to different rules (such as varying rules by job category or earnings level);
- Whether non-compete clauses for "senior executives" should be subject to different rules and, if so, how "senior executive" should be defined;
- Whether franchisees should be covered by the Proposed Rule; and
- Whether the FTC should instead consider disclosure requirements or reporting requirements related to non-compete clauses.

If the Proposed Rule becomes effective, employers will be granted 180 days to comply, including nullifying any existing non-compete or other prohibited agreements with current and former employees and notifying such employees that their prior non-compete clauses or agreements are no longer in effect. It is highly likely, however, that the final rule will face several legal and constitutional challenges.

If the Proposed Rule goes into effect as drafted, employers should be ready to take several actions, including:

- Within 45 days, notifying current and former employees who are currently subject to non-competes that the previously executed non-compete provisions are no longer effective;
- Strengthening agreements to protect the employer's confidential and proprietary information;
- Reviewing and, if necessary, revising non-solicitation agreements to cover legitimate interests without preventing competitive employment;
- Strengthening policies and procedures related to the protection of confidential and proprietary information, including identifying such information as confidential, limiting access to data and prohibiting the use of personal devices to access or work with confidential information; and
- Preparing to litigate trade secret claims under applicable state or federal law.

If you have any questions about the FTC's Proposed Rule, or how it may impact your organization, please contact your Kutak Rock attorney or a member of the firm's National Employment Law Group You may also visit us at www.KutakRock.com.