What Employers Need to Know about Non-Competes in 2024

Eric E. Packel and Emma R. Schuering, Polsinelli PC

2023 was a tumultuous year in the non-compete world. Non-competes came under unprecedented attack from all levels of state and federal government, especially including the Federal Trade Commission. The constantly evolving state of the law can leave employers confused and companies' competitive information vulnerable.

In the new legal landscape, companies must take a more nuanced approach to using restrictive covenants to protect against unfair competition. For some workers, like highly compensated executives or those with technical expertise and training, a non-compete may still be the right answer. But for many workers, it is not. Simply put, wholesale reliance on generic non-compete clauses with large portions of your workforce is a bad practice in 2024.

The recent challenges to the viability of non-competes are a reminder that a non-compete is just one tool available to employers to protect against unfair and unlawful conduct by a departing employee. This article outlines what employers are up against in using and enforcing non-competes in 2024 and recommends some strategies to consider in lieu of non-competes.

The Proposed FTC Rule Banning Non-Competes

Just days into 2023, the Federal Trade Commission proposed a rule banning employers from using non-competes with their workers.[i] Specifically, the Proposed Rule Forbids employers from (1) entering in to, or attempting to enter in to, a non-compete clause with a worker; (2) maintaining a non-compete clause with a worker; or (3) representing to a worker that the worker is subject to a non-compete clause unless there is a good faith basis for believing the non-compete is enforceable. The FTC defines "employer" and "worker" broadly to capture essentially any work force relationship, paid and unpaid, including everything from employees to independent contractors to volunteers.

Importantly, the Proposed Rule does not prohibit non-solicitation clauses, non-disclosure agreements, etc. However, the Proposed Rule includes a "functional test" for evaluating whether an agreement qualifies as a prohibited "non-compete clause." If a covenant prevents a worker from seeking or accepting employment after the conclusion

of the worker's engagement with the employer, it is prohibited by the Proposed Rule, regardless of how the covenant is entitled.

The Proposed Rule includes a limited exception for non-compete clauses between the seller and buyer of a business. By its own terms, the Proposed Rule does not apply to a non-compete clause entered in to (i) by a person who is selling a business entity or disposing of all of that person's ownership interest in the entity, or (ii) by a "substantial owner" (an owner holding at least a 25% ownership interest) who is selling all or substantially all of a business entity's operating assets. It remains unclear if the Proposed Rule is intended to ban non-competes not captured by the exception if the owner and seller do not have an employer-worker relationship.

Under the Proposed Rule, employers have significant responsibilities to the workers with whom they maintain non-compete agreements once the rule takes effect. If an employer has non-competes when the rule becomes effective, they are required to rescind those non-compete clauses within 180 days and provide notice of the recission to affected workers in "individualized communication" within 45 days of rescission. This includes providing notice to affected former workers who are subject to prohibited non-compete clauses if the employer has workers' contact information readily available. The recission language suggested in the Proposed Rule explicitly advises workers that they may seek or accept a job with a competitor, they may run their own competitive business, or compete with their former employer at any time after the end of their employment.

Other Attacks on Non-Competes

It seemed as though all levels of state and federal government were clamoring to weigh in on non-competes after the FTC's Proposed Rule announcement. Even President Biden specifically called them out during his 2023 State of the Union, reaffirming his administration's attention to free and fair labor market practices.[ii]

Congress joined the action with the reintroduction of Workforce Mobility Act, which seeks to ban non-compete agreements with limited exceptions.[iii] The Act is largely the same as the FTC Proposed Rule but includes a notable carveout for highly compensated individuals and executives. The Act had bi-partisan support, and we can expect it will be reintroduced again in some form or fashion in 2024.

Then in May 2023, the National Labor Relations Board General Counsel issued a Memorandum that the non-compete agreements between employers and employees interfere with employees' exercise of their rights under Section 7 of the National Labor Relations Act.[iv] The General Counsel outlined that non-competes chill employees from concertedly threatening to resign to demand better working conditions, concertedly seeking or accepting employment with a local competitor to obtain better working conditions, and soliciting their co-workers to go work for a local competitor. However, the Memorandum did concede that not all non-competes violate the NLRA, like those "narrowly tailored to special circumstances justifying the infringement on employee rights." As a result, employers may find themselves defending unfair labor practice

charges resulting from their use of non-compete agreements. The NLRA, and more recently the Department of Labor, have entered into agreements with the FTC to cooperate in policing non-competes—making it more likely an unrelated agency investigation could call into question an employer's use of non-competes.

Antitrust issues are also becoming more prevalent when navigating the use of non-competes. In addition to issuing the Proposed Rule, the FTC relied on its authority under the FTC Act to file complaints against companies for imposing non-competes on employees in a manner that the FTC claimed tended to harm competition, consumers, and workers. State attorneys general have also brought these kinds of claims more recently, especially targeting agreements with low wage-earning workers. Antitrust violations under state and federal law can carry criminal penalties, making it even more important for employers to narrowly tailor their non-competes and use them with only those employees whose duties warrant the post-employment restriction.

Over the last few years, numerous states have passed or tightened bans on the use of non-competes. Five states (California, North Dakota, Oklahoma, Colorado, and most recently, Minnesota) have essentially banned non-competes. California has always been hostile toward non-competes, but it just revised its law to require employers to notify current and former employees that their non-competes are void, creates a private cause of action, and provides for awards of attorneys' fees to aggrieved employee, adding teeth to its law. New York is expected to pass a virtual complete ban on non-competes in 2024 after a few versions were nearly signed by the Governor in late 2023. To date, nearly half of the remaining states have some form of a partial ban on non-competes on their books[v]—and that number is expected to increase in 2024.

So, What Now?

The Proposed Rule is just that—a proposal. The comment period has been closed since mid-2023, with the FTC receiving over 25,000 comments on the Proposed Rule, none of which have to be accepted or incorporated into the final rule. The general consensus is that a final rule is coming soon in the early part of 2024 and will look substantially similar, if not identical to, the Proposed Rule.

Once published as a final rule, employers can anticipate the final rule will face immediate legal challenge on numerous grounds with the final rule enjoined from taking effect in the interim (similar to the vaccine mandate challenges). The prevailing opinion is that there are strong arguments to attack the FTC's authority to make or enforce the rule, though as seen in 2023, even if the final rule is ultimately struck down in the courts, bans achieving the same outcome can come from other branches of federal or state governments. Regardless of the outcome of the Proposed Rule, the FTC's action is a reminder that non-competes are under ever increasing scrutiny and criticism, and employers must consider alternative ways to protect their confidential and trade secret information.

While waiting on a final rule from the FTC, employers are asking, “what now?” Employers should begin taking stock of their non-competes and evaluating critically whether those agreements are necessary or advisable in the current climate. Now is the time to re-evaluate strategies for protecting competitive information by focusing on other avenues available by contract or under law that do not rely on non-competes. This audit may include conducting a comprehensive review and identification of the company’s competitive, confidential and trade secret information; identifying who has access to that information; and evaluating how to best protect that information (potentially without the use of non-competes).

More generally, there are steps an employer can take to safeguard confidential information to help better protect it, even without a non-compete. Some of the safeguards include:

- Insuring access to shared files is on a need-to-access basis only; (ii) limiting access to client information to only those clients whom a particular employee services;
- Limiting access to research and development information to only those individuals in research and development who are working on the particular project;
- Reviewing and republishing policies forbidding the use of personal email accounts for business purposes;
- Implementing safeguards for the electronic mailing and sharing of confidential documents;
- Having employees acknowledge/reaffirm their understanding that company competitive information is owned by the company and only certain people are allowed access;
- Utilizing non-solicitation and non-disclosure covenants in appropriate circumstances.

Identifying and ensuring adequate protection for competitive information is paramount, given the ongoing threats to the viability of non-compete agreements – both at the state and federal levels. While this auditing process takes time and energy and is not a one size fits all solution, it is an investment in the protection of competitive information that will pay dividends if the need to protect that information through litigation ever arises with or without reliance on non-competes.

[i] The full text of the Proposed Rule and related materials is available at https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking.

[ii] See https://www.whitehouse.gov/state-of-the-union-2023/ ("We're banning those agreements so companies have to compete for workers and pay them what they're worth.").

[iii] The full text of the 2023 Workforce Mobility Act is available at https://www.murphy.senate.gov/imo/media/doc/workforce_mobility_act.pdf.

[iv] National Labor Relations Board, office of the General Counsel, Memorandum GC 23-08 (May 30, 2023), full text available at https://www.nlrb.gov/news-outreach/news-story/nlrb-general-counsel-issues-memo-on-non-competes-violating-the-national.

[v] For example, the Illinois Freedom to Work Act contains salary thresholds for employers subject to non-competes, a 14 day notice requirement, and an express instruction advising the employee to consult with an attorney before entering into the non-compete. The full text of the Act is available at https://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=3737&ChapterID=68.