



# NON-COMPETES AND FTC RULE

Maynard Nexsen Webinar Series

CHERIE BLACKBURN AND MARK BAKKER /// May 20, 2024



# COVENANTS NOT TO COMPETE

# FTC BOMBSHELL: REGULATORY CONTEXT

Not a vacuum – *a perfect storm*



- Much more aggressive regulatory environment under Biden Administration
  - Vaccine mandate (OSHA)
  - College loan forgiveness (DOE)
  - FLSA salary threshold (DOL)
  - Very active NLRB
  - Title IX regulations
- Final year of first term – lots of activity
- May 22 deadline for regulatory rulemaking



# FTC BOMBSHELL: FTC CONTEXT

- June 2021: Lina Khan appointed Chair FTC
- Very active FTC:
  - Consumer protection
  - Scrutinize big tech
  - Merger reviews/anti-trust lawsuits
  - AI misuse
  - “right to repair”
- Limited bipartisan support:
  - 21 R’s supported nomination
  - “one of the few Biden administration officials doing a pretty good job” (Sen. Vance)





# FTC BOMBSHELL: NON-COMPETE CONTEXT

- Restrictive covenants are historically province of states and courts
  - Patchwork of laws with a level of uncertainty
- President Biden in 2021 encouraged the FTC to **exercise whatever legal authority it has** to “curtail the unfair use of non-compete clauses” that “may unfairly limit worker mobility”
- Proposed Rule January 2023
- Final Rule April 2024
- 3-2 decision (majority Dem. appointed)



# FTC: JUSTIFICATION FOR RULE ON NON-COMPETES

When Congress created the FTC in **1914**, it empowered the agency to prevent “unfair methods of competition” through Section 5 of the FTC Act.

Under Section 5, FTC may condemn conduct that violates anti-competitive practices

109 year old rule – never used for rulemaking regarding noncompetes



# FTC RULE

- New proposed rule: a national blanket ban on non-compete agreements as an anti-competitive practice
- Effective September 4, 2024

## Banning noncompetes:

Good for workers, businesses, and the economy



### The FTC estimates that banning noncompetes will mean

- **More innovation:** an average of 17,000-29,000 more patents each year
- **More startups:** a 2.7% increase in new firm formation - that's 8,500+ new businesses per year
- **Higher earnings:** typical workers earn \$524 more per year

### Who's affected?



An estimated  
**18%**  
of U.S. workers  
are covered by  
noncompetes.

**That's 30 million people.**



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# FTC RULE: EXTRAORDINARILY BROAD

## Massive and Dramatic Revision to Non-compete Law

Covers all employees, workers, ICs...

### Impact on Employers:

- Ban on new non-competes
- Rescind existing noncompetes with notice to current and former employees under existing agreements
- Prohibit representations that workers are subject to non-competes

## National Standard: supersedes and preempts any inconsistent state laws, cases, and regulations

### Limited Exceptions:

- Sellers of a business (existing and future)
- “Existing” agreements with Senior Executives (151k/policymaking authority)
- Actions predating the rule and those brought in good faith





# FTC'S BROAD, FUNCTIONAL BAN

- Defines “non-compete clause” both broadly and functionally: *any contractual term between an employer and a worker that prevents 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*

Includes:

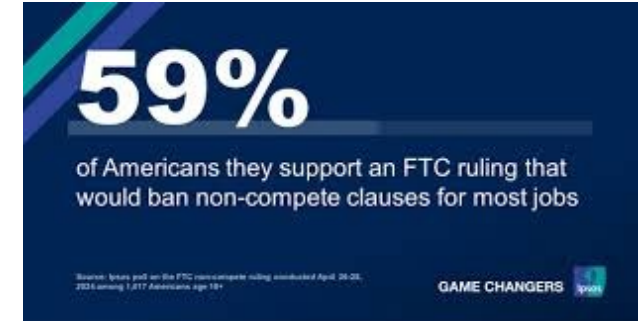
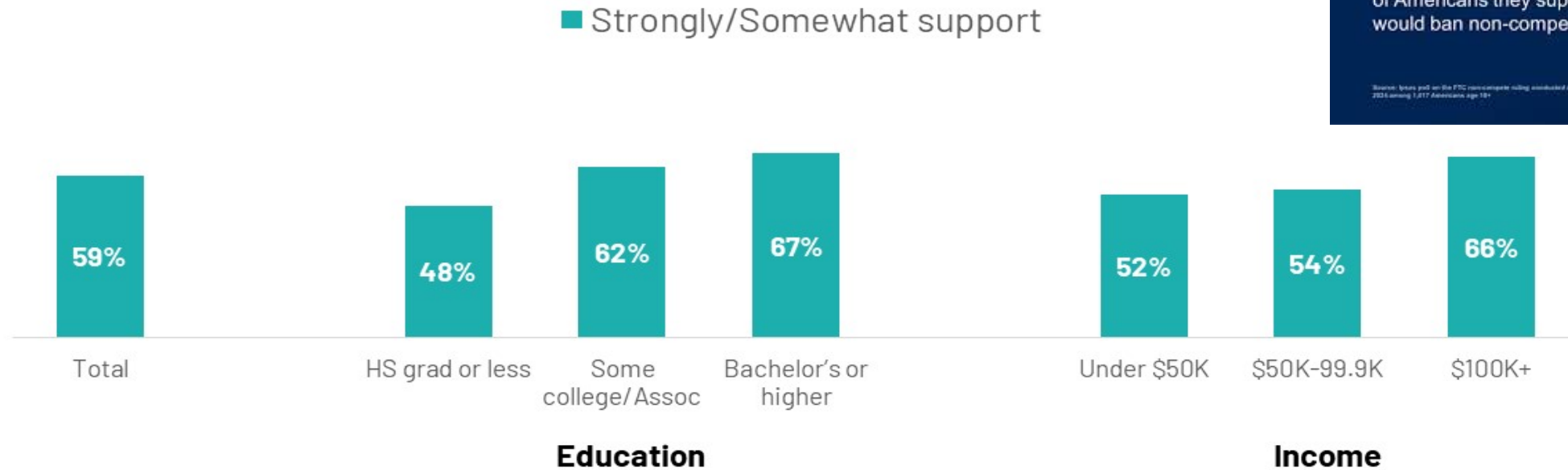
- Conventional non-competes – and labelling is not particular relevant
- Broad non-solicits and NDAs (“same inquiry”)
- Forfeiture or repayment provisions that unreasonably restrict movement to another job (e.g., agreement requiring workers to repay training costs where the repayment is not reasonably related to those costs/deferred comp eligibility)

**NOTE: potential for narrowly drafted non-solicitation agreements and NDAs to remain legal**

# REACTION - POSITIVE

## Highly educated, wealthier Americans more likely to support non-compete clause ban

Do you support or oppose the FTC banning non-compete clauses?



Base: All Americans (N=1,017), <\$50k (N=270), \$50k-\$99k (279), \$100k+ (N=468), HS grad or less (N=330), Some college/Associate's (N=262), Bachelor's or higher (N=425)

© Ipsos | FTC Non-Compete Poll

Source: Ipsos FTC Non-Compete Poll, fielded April 26-28, 2024





# REACTION - **NEGATIVE**

- At this time, there are **three pending legal challenges** to the FTC's Rule
- The court has issued a briefing schedule on the pending legal challenges:
  - **May 29, 2024:** FTC's deadline to file opposition to the motions for a stay and preliminary injunction
  - **June 12, 2024:** Deadline for the claimants to file a reply to opposition
  - **June 17, 2024:** Date of hearing (if necessary)
  - **July 3, 2024.** Anticipated date of the court's decision.
- This July 3 decision will provide guidance on the scale and steps employers need to take regarding implementation of this rule, currently set to go into effect on **September 4, 2024.**



# WHAT TO DO NEXT?

## Wait & See on FTC lawsuits

Executive non-competes – enter into prior to 9/4/24

Evaluate risk of consideration for new non-competes?

Understand the context and where things are moving

Adapt and prepare for a no-non-compete landscape or further limitations

Review non-solicits and NDAs

Take steps to ensure trade secrets and proprietary information remains confidential





# POLLING QUESTION

Does your  
organization  
currently utilize  
non-compete  
agreements for its  
employees?



# LARGER MOVEMENT TO CURTAIL NON-COMPETES

- State Activity – increased hostility
  - CA/MN/ND/OK banned non-competes
  - Many other states (e.g., MA/OR/WA) restrict non-competes
  - IL: 2021 Freedom to Work Act (income threshold) (9+ states)
  - Pending legislation in several states
- NLRB: May 30, 2023 memo (ULP)
- Bipartisan federal legislation: “Workforce Mobility Act of 2023”



# CURRENT NONCOMPETE REFRESHER FOR EMPLOYERS

In the meantime – still enforceable if certain factors are met – NC/SC example:

- (1) Limited to what is necessary for protection of “legitimate interest” of the employer
- (2) Reasonably limited with respect to time
- (3) Reasonably limited with respect to geographic territory
- (4) Not unduly harsh and oppressive in employee’s ability to earn livelihood
- (5) Reasonable from standpoint of sound public policy
- (6) Supported by valuable consideration
  - Commencement of employment
  - Additional consideration needed for continued employment

Courts “strictly construe” restrictive covenants against employers





# DRAFTING NON-COMPETES – BEST PRACTICES

## DO THIS

- ✓ Know your jurisdiction
- ✓ Think intentionally about protections needed
- ✓ Evaluate different positions differently (sales/management/access to trade secrets)
- ✓ Review and support geographic restrictions
- ✓ Think about ambiguities and whether particular situations would be unreasonable (e.g., janitor)
- ✓ Remind employees upon departure about obligations

## DON'T DO THIS

- × No one size fits all
- × Apply company wide irrespective of position
- × Broadly define scope, geographic territory
- × Never revisit, review, reform (position change)
- × Fail to take other measures and steps to protect assets, customer relationships
- × Delay taking action if breach of agreement
- × Hire a lawsuit!





# NON-SOLICITATION AND CUSTOMER RELATED COVENANTS


# IMPACT OF FTC RULE ON NON-SOLICITATION COVENANTS

- The Final Rule does not ban non-solicitation agreements unless they operate as a non-compete agreement and prevent the employee from accepting alternative employment or starting a company
- True non-solicitation clauses, which only restrict who an employee may contact after termination of employment, are not banned under the Rule.

# USE OF NON-SOLICITATION COVENANTS

- More favorable than non-compete covenants
- More likely to be enforced – business has legitimate interest in protecting its customers.

# STATE LAWS ADDRESSING NON-SOLICITATION COVENANTS

- Some state statutory laws specifically distinguish non-solicitation covenants from non-compete covenants
-  Some, such as California, consider them to be non-compete covenants
- Some restrict the ability to enter into a non-solicitation covenant



# COVENANTS NOT TO SOLICIT

## Covenant Not to Solicit Customers

- Employee agrees not to solicit customers

## Covenant Not to Solicit Employees

- Employee agrees not to solicit employees

## Other Non-Solicitation Covenants

- Employee agrees not to solicit vendors, suppliers, etc.

# EXAMPLE OF COVENANT NOT TO SOLICIT CUSTOMERS

- “For a period of twelve (12) months following the termination of Employee’s employment with the Company, for any reason, whether by the Company or Employee, Employee shall not, directly or indirectly, on behalf of employee or any third party or entity, solicit, call on, or otherwise attempt to divert any Customer (as defined herein) of the Company for purposes of providing *[describe services]*.”
- For purposes of this Agreement, “Customer” means *any customer of the Company with whom Employee worked directly or had material contact at any time in the final twelve (12) months of Employee’s employment with the Company.*
- Check applicable state law.

# EXTENSION OF NON-SOLICITATION COVENANT – AGREEMENT NOT TO PERFORM SERVICES

- Employee agrees not to perform competitive services for a customer.
- Covenant is limited to customers, but is broader than solicitation.

# POLLING QUESTION

How many of you  
utilize a covenant  
that prevents an  
employee from  
**performing services**  
for customers?





# EXAMPLE OF COVENANT NOT TO PERFORM SERVICES FOR CUSTOMER

- For a period of twelve (12) months following the termination of Employee's employment with the Company, for any reason, whether by the Company or Employee, Employee shall not, directly or indirectly, on behalf of himself or any third party or entity, **perform or engage in any services for any Customer** (as defined herein) of the Company **that are competitive with the services provided by the Company**.
- For purposes of this Agreement, "Customer" means any customer of the Company with whom Employee worked directly or had material contact at any time in the final twelve (12) months of Employee's employment with the Company.
- Check applicable state law.

# GENERAL REQUIREMENT FOR A NON-SOLICITATION COVENANT

- **Supported by Consideration**
- **Reasonable in scope**
  - Definition of customer takes the place of the geographical scope (found in a non-compete)
  - Reasonable time limitation
- **Necessary for the legitimate business interests of the employer**
- **Not unduly harsh on the employee's ability to earn a livelihood.**

# MORE TIPS FOR DRAFTING COVENANTS NOT TO SOLICIT CUSTOMERS

- Check the law of the state **where the employee resides** before drafting.
- Ask: What is the consideration? Job? Continued employment (check state law)? Raise? Bonus? Some other benefit to employee?
- Be sure to include a severability clause and to separate covenants in sections and subsections.
- Include a blue pencil provision – state law governs enforcement.

# TIPS IN DRAFTING COVENANTS NOT TO SOLICIT CUSTOMERS

- Include covenant not to perform services for a customer.
- Be sure to define “customer”
  - Those whom employee has had contact or involvement
  - Those who were customers within a certain time period
- Limit the time period of covenant in accordance with state law
- Limit to competitive services – define what these are
- If diverse services/divisions, consider the employee's position/duties.
- Don't include “affiliates” unless applicable.



# NON-DISCLOSURE COVENANTS



# BENEFITS TO NDAs

- Evidence of employer protecting confidential information and trade secrets
- Allows employer to describe specific information that is confidential.
- Ability to sue for breach of contract.
- Attorneys' fees if included in contract.
- Can include Defend Trade Secrets Act required notice.

# UNIFORM TRADE SECRETS ACT (“USTA”)

- Drafted by the National Conference of Commissioner on Uniform State Laws in an effort to bring ‘uniformity’ to trade secrets disputes. USTA is not a federal *law*.
- Adopted in 1979. At the time, common law of each state governed trade secrets disputes.
- Some version of the USTA has been adopted as statutory law in all states (except New York) and the District of Columbia.

# USTA DEFINITION OF TRADE SECRETS

- Information, including a formula, pattern, compilation, program device, method, technique, or process, that:
  - (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
  - (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy



# DEFEND TRADE SECRETS ACT (DTSA)

- Enacted in 2017.
- Amendment to the federal Economic Espionage Act of 1996 to create a civil remedy for the misappropriation of trade secrets.
- Since DTSA is a federal law, employer can sue in federal court for a violation of the DTSA.

# DTSA DEFINITION OF TRADE SECRETS

- All forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing if—
  - the owner thereof has taken reasonable measures to keep such information secret; and
  - the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information.

# DTSA NOTICE REQUIREMENTS

## Employer notice requirements concerning immunity

- Employers must provide **notice to employees** regarding the **DTSA's immunity provisions** if they want to recover certain remedies, including exemplary damages and attorneys' fees
- Notice shall be provided "in any contract or agreement with an employee that governs use of a trade secret or other confidential information"
- Usually included in NDA – *if the employer is willing to affirmatively address whistleblower protections*



# DTSA NOTICE

- An individual shall not be held criminally or civilly liable under any Federal or State trade secret law for the disclosure of a trade secret that—
- (A) is made—
  - (i) in confidence to a Federal, State, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or
- (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal.

# TIPS FOR DRAFTING NON-DISCLOSURE COVENANTS

- Define confidential information – using elements to “trade secret” definition.
  - Include time limitation.
- Provide specific applicable examples of confidential information.
- Make sure definitions are consistent in all documents.
- Be careful with generic non-applicable language – think of how you would respond to questions under oath about the language in your NDA.
- Consider whether you need to include “affiliates” or your customer/client’s information.
- Include necessary DTSA language.

# POLLING QUESTION

How many of you  
have a non-  
disclosure provision  
in your handbook?



# USE OF NDAs

**Best Practice: Have employee sign when hired. Generally no additional consideration for trade secret protection.**

**Include in Employment Agreement or in Agreement with other covenants or as a stand-alone NDA.**

**Do not put NDA language in your Employee Handbook. Include a confidentiality policy (without contractual language) instead.**

# Thank You

## CONTACT

**Cherie Blackburn**

(843) 720-1728

[cblackburn@maynardnexsen.com](mailto:cblackburn@maynardnexsen.com)

**Mark Bakker**

(864) 282-1175

[mbakker@maynardnexsen.com](mailto:mbakker@maynardnexsen.com)