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ANALYSIS

Understanding the Push To Eliminate Non-Compete Agreements

In this article, Seth M. Pavsner and Tyler Mitchell discuss the Federal Trade Commission's new proposed rule that would classify non-compete agreements in employment contracts as an "unfair method of competition."

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Employment Law

By Seth M. Pavsner and Tyler Mitchell | November 03, 2023 at 10:00 AM

It should come as no surprise that the long tail of the pandemic has led to tension between labor and management. As employers have, over the past year-plus, begun calling their employees back to the office, those same employees—having adapted to maintain a work-life balance without ever leaving their homes—have resisted. The predictable result has been an increase in labor movement, as workers flock to employers who offer greater flexibility and better perks over the simpler considerations of the past (e.g., gross income).

Employers have long turned to the courts to enforce reasonable restrictive covenants in their employment contracts, particularly non-compete agreements (NCAs) that limited employees' mobility within their field. Indeed, New York is one such state where reasonable NCAs may be enforced. *See BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388-89 (1999) ("The modern, prevailing common-law standard of reasonableness for employee agreements not to compete applies a three-pronged test. A restraint is reasonable only if it: (1) is *no greater* than is required for the protection of the *legitimate interest* of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public") (citations omitted; emphasis in original).

While courts have viewed NCAs with a skeptical eye, those protecting legitimate business interests are often upheld if reasonable in scope (holding that NCAs more often upheld where they "protect[] against misappropriation of the employer's trade secrets or of confidential customer lists, or protect[] from competition by a former employee whose services are unique or extraordinary") (citations omitted).

But there is a growing sentiment among workers that these NCAs are anticompetitive and even punitive in nature, and the election of pro-labor governments in 2020—both at the New York state and federal levels—has accelerated this discourse.

On Jan. 5, 2023, the Federal Trade Commission (FTC) published a new proposed rule that would classify NCAs—broadly defined to mean "a 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"—in employment contracts as an "unfair method[] of competition." Federal Trade Commission, "Non-Compete Clause Rulemaking," Jan. 5, 2023.

The FTC's proposed new rule targets not only express NCAs, but also de facto NCAs, including an entire subsection devoted to a "[f]unctional test for whether a contractual term is a non-compete clause."

But why take aim now at NCAs, when they have been approved by courts across the nation (provided they are reasonable in scope, as discussed in *BDO Seidman*)?

The number of workers presently bound by NCAs is startling: per the FTC, about one in five American workers—more than *30 million* people—are so bound, and thus restricted from pursuing alternative employment opportunities. And those employees who have signed NCAs are disproportionately low-income and low-education workers, rather than professionals, upper management or C-suite executives who might be able to take business or trade secrets with them out the door.

Indeed, the Economic Policy Institute has found that (1) nearly a third of employers require *all* employees to enter into NCAs, regardless of pay or job duties; (2) *more than half* of workers making between $13.00 and $16.99 per hour are employed by persons or companies that utilize NCAs (just over 30% of which have mandatory NCAs for all of their employees); and (3) over 47% of workers who have no education above the high school level work for an employer with mandatory NCAs for all employees. *See* Alexander J.S. Colvin and Heidi Shierholz, "Noncompete agreements", Economic Policy Institute, Dec. 10, 2019.

Similarly, the National Employment Law Project found last year that nearly 30% of NCAs cover workers who make less than $13 per hour, which is a far cry from the provisions' intended purpose of protecting trade secrets and other confidential information. *See* Najah A. Farley, "How Non-Competes Stifle Worker Power and Disproportionately Impede Women and Workers of Color", National Employment Law Project, May 18, 2022.

These statistics paint a clearer picture of the impact of NCAs on the workforce. Though the intent behind allowing NCAs was reasonable from the employer perspective—i.e., to protect their business from the dissemination of proprietary information and the loss of clients brought in by employees at the employer's expense—the practical effect has been a chilling of labor mobility on those who can least afford it, and who cannot afford to challenge even unreasonable NCAs in court.

On May 30, 2023, Jennifer Abruzzo, general counsel for the National Labor Relations Board (NLRB), issued a memorandum arguing that NCAs interfere with employees' ability to exercise their rights under Section 7 of the National Labor Relations Act the National Labor Relations Act (the Abruzzo Memo). *See* NLRB Office of Public Affairs, "NLRB General Counsel Issues Memo on Non-competes Violating the National Labor Relations Act", May 30, 2023.

The Abruzzo Memo posits that NCAs "reasonably tend to chill employees in the exercise of their Section 7 rights when the provisions could reasonably be construed by employees to deny them the ability to quit or change jobs by cutting off their access to other employment opportunities that they are qualified for[.]"

Significantly, NCAs have a secondary effect of dissuading employees from attempting to organize, because if they are terminated (unlawfully) for doing so, "they will have greater difficulty replacing their lost income[.]" And because non-disclosure and non-solicitation provisions remain largely untouched as reasonably justifiable means for employers to protect their proprietary information and books of business, NCAs as currently constructed serve only to lock low-education workers into low-income jobs and can effectively be mooted from the employer's perspective with reasonable non-disclosure and non-solicitation agreements in employment contracts.

Now, inspired by federal action, New York is pushing through legislation to ban NCAs at the state level. Senate Bill S3100A, which would update the New York Labor Law and "codify [the FTC's interest in banning NCAs] in state law," aims to prohibit and render void, with limited carveouts, "any agreement, or clause contained in any agreement, between an employer and a covered individual that prohibits or restricts such covered individual from obtaining employment, after the conclusion of employment with the employer included as a party to the agreement[.]" Senate Bill S3100A.

The bill provides a legislative justification that, inter alia, “[n]on-compete agreements have a negative effect on the labor market and economy of New York state [because t]hey prevent workers from seeking employment at entities that may be a better fit, and they [prevent] employers from providing more competitive benefits and wages, because their workforce cannot seek employment elsewhere.”

Further, Senate Bill S6748 (which is not as far along the legislative process, and primarily focuses on antitrust issues) also contains a proposed section banning any “de facto non-compete clause because 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.” Senate Bill S6748 at §8(1)(a)(2).

Notably, Senate Bill S6748 would also expressly ban training repayment agreement provisions (commonly known as TRAPs)—a recent favorite provision for employers seeking to stop employees from getting free training on the employer’s dime and then taking it with them to serve a competitor—to the extent the required payment “is not reasonably related to the costs the employer incurred for training the worker.”

New York is not alone in seeking to ban or severely limit TRAPs: in September 2023, the NLRB filed a consolidated complaint against Ohio-based company Juvly Aesthetics, which included among its several causes of action violations of Sections 7 and 8(a)(1) of the National Labor Relations Act, for demanding repayment of training costs from multiple employees in excess of $50,000 each. *See* NLRB Office of Public Affairs, Region 9-Cincinnati Issues Complaint Alleging Unlawful Non-Compete and Training Repayment Agreement Provisions (TRAPs), Sept. 7, 2023.

These trends paint a very pro-labor picture of the future for worker mobility, but hope is not lost for employers who want to keep hold of their home-grown talent. First, because neither non-disclosure agreements nor non-solicitation agreements are in the governments’ crosshairs, employers can sleep soundly knowing their trade secrets and client bases are protected even if NCAs are ultimately banned. Second, a likely solution could be found in “longevity incentives,” i.e., monetary bonuses or nonmonetary perks rewarding employees for longer service to the employer.

Assuming these employee-friendly laws do pass (currently likelier at the New York state level than the federal level), employers would do well to bake positive reinforcement rewards into their employment contracts rather than negative incentives such as TRAPs.

Rather than risk the ire of the state, the federal government and the courts, employers can ride the pro-labor wave by keeping their employees satisfied and rewarding them for staying put.

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