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FTC proposes ban on non-compete agreements

Quick legal challenge expected

Experts say businesses should start preparing for new federal rules that would put significant limits on employment contracts that limit what workers do when they leave a company.

The Rochester Business Journal recently hosted a virtual panel discussion on a proposed federal ban on non-compete agreements (NCA) and a new state pay transparency law. The discussion was sponsored by Adams Leclair LLP, Harris Beach PLLC and Phillips Lytle LLP.

The expert panel included: Attorneys Daniel Palermo, an associate at Harris Beach PLLC; Mark F. Pincelli, an associate at Phillips Lytle LLP; and Stacey Trien, a partner at Adams Leclair, LLP.

Palermo explained that new pay transparency laws at the state and local levels has been a growing trend. New York state's new pay transparency law will take effect in September.

Palermo

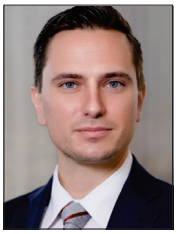
The law will apply to employers with four or more employees and will cover recruiters, but not temporary staffing firms.

Many details have not been decided, but the state Labor Department is expected to provide more information soon.

Under the new law, job postings must include a range of compensation and a job description. The law also applies to internal job postings.

Civil penalties for violating the law start at a maximum of $1,000 for the first violation.

FTC rules proposed in January



Pincelli

Pincelli explained that the Federal Trade Commission is currently accepting public comments on proposed rules that would ban NCAs nationwide.

Currently, the laws governing NCAs vary by state. In some places, to be enforceable, an NCA must be tied to adequate consideration, not just continued employment, or it must be tied to a job offer, a promotion, or a bonus, or a pay raise.

Usually, NCAs limit an employee's ability to work elsewhere in a certain capacity after leaving a job, such as working for a competitor or start a competing business.

Employers also use confidentiality agreements and non-disclosure agreements (NDA) to keep some information confidential, such as trade secrets, customer lists, and pricing models.

Employers also use agreements that require employees to pay for training if they leave a job within a certain time period.

In New York state, restrictive covenants are "disfavored," Pincelli said. But they are generally enforceable if they are reasonable and protect a legitimate interest of the employer. The time period and geographic location must be "reasonably limited," he said.

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>
> *-Mark F. Pincelli*

On Jan. 25, the FTC proposed a very broad ban on NCAs. The rationale for the proposal is that NCAs prevent new businesses from forming, stifle entrepreneurship and prevent innovation, Pincelli said.

According to the FTC, half of private sector businesses require at least some employees to enter into non-compete agreements, and they affect more than 30 million people.

The FTC claims the ban will increase American worker earnings by $250 billion to $296 billion.

The proposed FTC rule would apply to any private business, except for companies that are not under FTC authority, such as financial institutions.

The FTC rule would prohibit forcing workers to pay for training if they leave the job in a certain time period if the payment is not reasonably related to the cost the employer incurred to train the worker, Pincelli said.

Under the proposed rule, existing non-compete contracts must be rescinded, and employers must provide notice to workers that non-compete clauses are no longer in effect and not enforceable.

Companies will even have to provide notice to former workers if they have contact information.

The new rule would not apply to individuals selling businesses or their interest in a business.

Pincelli said there have already been 5,000 public comments on the proposed rules.

"They anticipate this is probably going to be the most commented on FTC proposed rule in FTC history," he said.

FTC and New York state are already taking action

Trien

Trien talked about the practical effects of the proposed FTC rules and the current status of New York state law on the subject.

"Often these clauses are used more as a tactic with respect to keeping employees and reducing competition rather than making sure the clause is actually going to be enforceable when it goes into court," Trien said.

"That's the reason why the proposed rule requires employers to have to actually inform employees and past employees if this rule goes into effect that these clauses are not actually enforceable even though they may have one," she said.

> **"The cost of defending these lawsuits is enough to preclude employees from violating the terms of the non-compete..."**
>
> *-Stacey Trien*

Even in states where NCAs are not enforceable, companies use them at the same rate as workers in other states, Trien said.

"It's often a large multinational corporation that has this agreement and doesn't mind spending tens of thousands of dollars in litigation and tries to go after the former employee who is starting a new company, or going to a smaller business," Trien said.

"The cost of defending these lawsuits is enough to preclude employees from violating the terms of the non-compete, even if, at the end of the day, the judge would throw the case out because it's not actually enforceable," she said.

In New York state there are two types of NCAs that are generally enforceable: Agreements that bar former workers from soliciting employees or former customers, as long as its narrowly tailored to protect a legitimate business interest, and non-disclosure agreements to protect confidential information.

But NCAs that say you can't work for a competitor for one or two years in a particular geographic location are "more disfavored by courts in New York," Trien said.

The legal tests for enforceability in New York state are whether the clause is narrowly tailored to protect the legitimate interest of an employer and whether it is tailored to protect trade secrets, or confidential customer lists, or to protect the employer from competition by an employee whose services are "unique or extraordinary."

"This category — unique or extraordinary — is virtually never found to exist," Trien said.

Employers still include these clauses in contracts because it presents a threat of litigation even if the court won't ultimately enforce it, she said.

Trien said the main impact of the proposed FTC rule is that it would stop employers from including broad non-compete clauses in contracts and employers would have to notify employees that those clauses are not enforceable.

If the FTC actually officially issues the new rule, Trien expects it will be immediately challenged in court and an injunction will be issued preventing enforcement while several issues are decided.

In particular, courts must decide whether the FTC actually has the authority to issue such a rule, whether Congress had authority to delegate the rule-making authority and whether it should be Congress that adopts a statute instead.

Regardless, FTC officials, under the authority to ban unfair competition, have already started legal actions against companies that require broad non-compete agreements on a large scale.

And the New York State Attorney General's Office is investigating companies with broad NCAs.

There is a bipartisan bill in the U.S. Senate that would ban NCAs, but it's doubtful that it will be passed, Trien said.

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