Non-Competes: One Step Forward and Two Steps Back

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In 2024, two federal agencies saw challenges to their regulations restricting non-compete agreements, while several states enhanced restrictions or proposed amendments expanding existing non-compete laws.

The scope and impact of these developments are likely to be further clarified as legislation and new case law develops.

FTC Rule

In early 2024, the Federal Trade Commission (FTC) issued a final rule banning most existing and new non-competes, broadly including any covenant or mix of covenants that "function to prevent a worker from joining a competitor."[1] The rule covered all U.S. employees, including senior executives, with exceptions for (i) non-competes entered into in connection with the bona fide sale of a business; (ii) existing non-competes with senior executives, defined as workers in a "policy-making position" who earn more than $151,164 annually; and (iii) contracts between a franchisee and a franchisor. The rule also required that employers provide notice to workers who are subject to a non-compete provision that the non-compete will not and cannot legally be enforced against them.

Although the rule's scheduled effective date was September 4, 2024, it faced many legal challenges and, on August 20, 2024, was vacated by a federal court in Texas on a nationwide basis. The FTC challenged that decision in a notice of appeal on October 18, 2024,[2] and the FTC also defended the rule in an Eleventh Circuit appeal on November 4, 2024.[3] Further challenges are likely to be seen in 2025, and we anticipate it will be some time until final decisions are rendered by the courts. For now, the rule remains vacated and state law currently controls the applicability of any non-compete and other restrictive covenants.

NLRB Enforcement

The National Labor Relations Board's (NLRB's) May 2023 memorandum stating that most non-compete agreements violate the National Labor Relations Act has spurred a number of enforcement actions, one of which has altered the framework the NLRB utilizes to assess the validity of restrictive covenants. In August 2023, the NLRB decided to adopt a new burden-shifting framework for restrictive covenants that requires evaluating whether a facially neutral work rule or policy could reasonably be interpreted to be coercive "from the perspective of an employee who is subject to the [challenged] rule and economically dependent on the employer."[4] If that burden is met, the NLRB will find the rule presumptively unlawful, though the presumption can be rebutted by the employer with adequate evidence.

The framework has been used in subsequent cases, one of which involved rescinding non-compete provisions in an employment agreement on the grounds that they chilled union-organizing activity.[5] In the case, an employee who engaged in "salting," a practice that involves taking a non-union job intending to organize a workforce, was discharged by their employer.

The challenged non-compete provisions prohibited employees from soliciting or persuading other employees of the employer to leave their employment and engaging or working in any other similar or competitive businesses following their separation from the employer. The

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provisions also required the employee to report any solicitation offers they received. In June of 2024, the NLRB found these provisions to be in violation of the National Labor Relations Act and ordered their recission.

State Developments

Restrictions on non-compete clauses have also been developing rapidly at the state level. Currently, total bans on non-competes are in effect in California (whose retroactive notice requirement went into effect on January 1, 2024, with a deadline for compliance shortly thereafter), North Dakota, Oklahoma and, most recently, Minnesota.

Building on its existing non-compete ban, the Minnesota House proposed a bill, HF 3456, that would apply to service providers and prohibit restrictive covenants in service contracts, intending to close a loophole in its current non-compete ban that allows service providers to subject employees to non-solicit and no-hire restrictions through intercompany contracts. This bill was scheduled for further action in the Minnesota House on March 7, 2024, but thus far no further action has been taken.

In Delaware, a January 2024 ruling by the Delaware Supreme Court reversed a previous decision by the Court of Chancery and upheld the enforceability of restrictive covenants in partnership agreements, which conditioned distributions on partners' compliance with non-compete and non-solicit provisions.[6] As the subsequent application of this case has created some ambiguity for courts reviewing provisions governed by Delaware law, the Seventh Circuit recently certified two questions to the Delaware Supreme Court about the scope of the ruling, for which arguments were heard on October 9, 2024.

In Massachusetts, *Miele v. Foundation Medicine Inc.*, a case decided this past July, clarified that the Massachusetts Noncompetition Act (MNAA) does not apply retroactively from its effective date of October 1, 2018, though the court held that reaffirmation of an existing agreement creates a new agreement for purposes of the effective date. The court also held that forfeiture-for-competition provisions, which are covered under the MNAA, include non-solicits and no-recruit covenants. On November 4, 2024, the defendant filed its opening brief in an application for direct appellate review.

Finally, Washington amended its non-compete laws with Senate Bill 5935 (S.B. 5935), effective June 6, 2024, which expanded the definition of "non-competition covenant" to include agreements that directly or indirectly prohibit the acceptance or transaction of business with a customer. Employers should be focused on a few key aspects of the amendments, namely that employers must disclose non-competition covenants to prospective employees by the time of an employee's initial acceptance of an employment offer, regardless of whether the offer is oral or written. Additionally, the amendment clarified that a person aggrieved by a noncompetition covenant, regardless of whether or not they were a party to the covenant, can pursue relief.

Next Steps

As an ongoing matter, employers should catalog where employees are located and be prepared to track both current and former employee mobility to ensure compliance with non-compete restrictions, review and revise form agreements for any potentially void non-compete clauses and continue to consult with counsel and monitor these and other developments over the coming year.

Notes

1. FTC, "FTC Announces Rule Banning Noncompetes" (April 23, 2024), available here.

2. *See Ryan, LLC v. Federal Trade Commission* (N.D. Tex. August 20, 2024).

3. *See Properties of the Villages Inc. v. Federal Trade Commission* (M.D. Fla. August 15, 2024).

4. NLRB Office of Public Affairs, "Board Adopts New Standard for Assessing Lawfulness of Work Rules" (August 2, 2023), available here.

5. *See J.O. Mory, Inc. and Indiana State Pipe Trades Ass'n a/w United Assn. of Journeymen and Apprentices of the Plumbing and Pipefitting Indus. Of the United States and Can., AFL-CIO* (June 13, 2024).

6. *See Cantor Fitzgerald, L.P. v. Ainslie*, C.A. No. 9436 (Del. January 29, 2024).