Legal Update Article

Keeping Up With the Changing Law Restricting Employee Competition in the Construction Industry

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Construction
Restrictive Covenants, Trade Secrets and Unfair Competition

The legal landscape is rapidly changing with regards to restrictive covenants used by employers to protect against unfair competition and solicitation by current or former employees. This is especially true for employees in safety-sensitive positions or who work on government contracts subject to federally mandated compliance.

Construction-industry employers need to review their employment agreements to ensure they follow the current requirements dictated by federal and state laws on restrictive covenants, including noncompete provisions.

Executive Order; Proposed Rule

The July 9, 2021, Executive Order (EO) issued by President Joe Bidendid not change the law of restrictive covenants directly. Rather, it "encouraged" the Federal Trade Commission (FTC) to act to regulate "the unfair use" of non-compete clauses and other restrictive covenants.

President Biden issued the EO to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility." The language of the EO suggests that President Biden wants the FTC to act against abuses of restrictive covenants, rather than their reasonable use.

In response, the FTC proposed anew rule that, if finalized as currently proposed, would effectively prohibit non-compete agreements with employees, other than in exceptionally limited circumstances. If adopted, the proposed rule will require all employers that use any agreement containing a non-compete clause (or a clause deemed to be a *de facto* non-compete under the proposed rule's expansive definition) to take action to *rescind* the non-compete clause.

The proposed rule's sale of business exception will not apply to a non-compete clause entered into:

a. By a person who is selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity; or

b. By a person who is selling all or substantially all of a business entity's operating assets.

However, this exception applies only when the person restricted by the non-compete clause, at the time the person enters the non-compete agreement, is an owner, member, or partner holding at least a 25 percent ownership interest in the entity.

A final rule has not yet been issued. The public comment period ends April 19, 2023. (For a thorough analysis on FTC's proposed rule, see our special report, A Deeper Dive Into FTC's Proposed Non-Compete Rule.)

While this new rule is pending, the FTC continues to enforce actions against employers on alleged imposed harmful restrictions, including bringing its fourth enforcement action of 2023. On March 15, 2023, the FTC restricted an employer from what it views as unfair methods of competition. The FTC filed an action against a manufacturer that sells glass containers used for food and beverage packaging. The employer-imposed restrictions barred employees for one year from working with another employer in the United States that provides "rigid packaging sales and services which are the same or substantially similar" to those in which the employer deals. They also are barred from selling products or services to "any customers or prospective customers of [the employer] with whom the worker had any interaction."

The FTC found the restrictive covenants harmed workers and competing businesses and would lead to lower wages and salaries, reduced benefits, less favorable working conditions, and would block competitors from entering and expanding their businesses.

The agency banned the employer from non-compete restrictions on relevant workers and telling its employees that they are subject to non-compete provisions and, for the next 10 years, required the employer to provide "clear and conspicuous notice to any new relevant employees that they may freely seek or accept a job with any company or person, run their own business, or compete with [the employer] at any time following their employment."

Be Aware of State, Federal Law Changes

Unsurprisingly, in addition to federal edicts and legislation, some states appear to be moving toward legislation and case law imposing further restrictions on employers' use of restrictive covenants. Thus far in 2023, 65 bills have been introduced (two have already failed) in 24 states to legislate restrictive covenants. These bills continue to be introduced despite the FTC's proposed ban discussed above. For example, in New York, "An Act to Amend the Labor Law, in Relation to Prohibiting Non-Compete Agreements and Certain Restrictive Covenants" was introduced on January 27, 2023, and is pending committee review.

In addition, federal legislation continues to move forward. Congress is considering the "Workforce Mobility Act of 2023," a bipartisan bill that would ban the use of restrictive covenants nationally. Three other similar bills in Congress are pending.

States that allow restrictive covenants with restrictions can be a guide to how construction industry employers can craft enforceable agreements. For example, Connecticut has historically allowed non-competes in employment and does not have general statutes or regulations to govern the matter, despite a late-2022 effort by the Connecticut legislature to pass H.B. 5249, a bill to codify non-competes. The Connecticut bill was reintroduced as H.B. 6594 in February 2023 to limit non-competes and is pending committee review.

Under Connecticut common law, to determine enforceability of non-competes, the courts look to:

1. The length of time of the restriction;
2. The geographic scope;
3. Fairness of the protection provided to the employer;
4. The extent of the restraint on the employee's ability to pursue the employee's

occupation; and
5. The extent of any interference with the public interest.

In Connecticut, the offer and acceptance of employment is sufficient consideration to support a non-compete agreement signed at the beginning of employment. However, to support a non-compete agreement for a current employee, continued employment must be accompanied by additional consideration, such as a promotion, raise, or new position. Additionally, Connecticut courts can modify the terms of the non-compete restrictions and enforce them as modified. However, to do so, the non-compete agreement must state the intent to make the terms severable.

In one decision, the Connecticut Appellate Court remanded a case to the trial court, holding a genuine issue of material fact existed as to whether there was sufficient consideration for the employee's nondisclosure agreement and whether there was a connection between the nondisclosure agreement and the managing director's continued employment. In ***Schimenti Constr. Co., LLC v. Schimenti***, 217 Conn. App 224, 226 (2023), a construction management firm that employs more than 200 employees at its headquarters located in Ridgefield, Connecticut, filed suit against its former managing director. When the former employee was promoted from managing director to project executive in 2014, he signed a nondisclosure agreement, which included a two-year non-competition provision, as a condition of his continued at-will employment. In 2018, the managing director resigned and accepted a position at JRM Construction Management, a construction company in New York City. Subsequently, Schimenti Construction Company, LLC filed suit against the employee, claiming the former managing director breached the nondisclosure agreement he signed.

Takeaways

The laws around restrictive covenants are changing. Employers need to be alert to how their non-compete agreements are entered into and structured, being especially attentive to state-required nuances and federal changes to this area of law.

In general, restrictive covenants should be drafted narrowly to protect a legitimate business interest of the employer, such as trade secrets, confidential information, or customer goodwill, and must be reasonable in terms of duration, geography, and scope of activities prohibited.

Although Connecticut law allows courts to modify agreements where employers included severability clauses, many states do not allow courts to make such modifications and agreements can be stricken as entirely unenforceable.

Construction-industry employers that wish to require employees to enter restrictive covenants should consult with experienced employment law counsel beforehand to ensure such agreements are up to date and enforceable.

If you have any questions about non-competes and restrictive covenants within the Construction Industry, please contact one of the authors of this article or the Jackson Lewis attorney with whom you regularly work.