Legal Update Article

A Renewed Attempt in Congress to Eliminate Non-Compete Agreements

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Restrictive Covenants, Trade Secrets and Unfair Competition

A bipartisan bill aimed at generally banning non-compete agreements across the country has been introduced in the Senate by Senators Chris Murphy (D-Conn.) and Todd Young (R-Ind.). The Workforce Mobility Act of 2019, which closely tracks the Democrat-led Workforce Mobility Act of 2018, is a stark contrast to the limited and more measured approaches that have predominated at the state level.

How We Got Here

In 2016, the Obama Administration launched an initiative criticizing the alleged abuse of non-compete agreements in the United States. That initiative led to the issuance of an executive order and three reports: (1) April 2016 Executive Order, "Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy"; (2) March 2016 Treasury Department report, "Non-Compete Contracts: Economic Effects and Policy Implication"; (3) May 2016 White House report, "Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses"; and (4) October 2016 White House report, "State Call to Action on Non-Compete Agreements." These documents criticized non-compete agreements for purportedly reducing the welfare of workers, artificially restricting competition, and hampering the economy's efficiency by depressing wages, limiting mobility, and inhibiting innovation.

The October 2016 Call to Action, in particular, urged state policymakers to pursue best practice policy objectives, including:

1. Banning non-competes for certain categories of workers, such as:

- Workers below a certain wage threshold;
- Workers in certain occupations that promote public health and safety;
- Workers who are unlikely to possess trade secrets; and
- Workers who are most susceptible to the adverse impacts from non-competes, including those who are laid-off or terminated without cause.

2. Improving transparency and fairness of non-compete agreements by, for example:

- Disallowing non-competes unless they are proposed before a job offer or significant promotion has been accepted (because an applicant who has accepted an offer and declined other positions may have less bargaining power);
- Providing consideration over and above continued employment for workers who sign non-compete agreements; and
- Encouraging employers to better inform workers about the law in their state and the existence of non-competes in contracts and how they work.

3. Discouraging the use of overly restrictive or otherwise improper non-competes, including by:

- Promoting the use of the "red pencil doctrine," which renders contracts with unenforceable provisions void in their entirety; and
- Imposing appropriate remedies or penalties on employers that violate the applicable state non-compete statutes.

Although the Call to Action recommended state action, the U.S. Congress responded by pursuing federal non-compete reform. Three Democratic senators, Elizabeth Warren (Mass.), Christopher Murphy (Conn.), and Ronald Wyden (Or.), sponsored the Workforce Mobility Act of 2018. Democratic members of the House introduced a similar bill at the same time. Rather than adopt the Obama Administration's endorsement of a nuanced approach to non-compete reform, both versions of the 2018 Act opted instead to ban employee non-competes entirely.

The 2018 Act stalled at the start. Perhaps recognizing the 2018 Act's excesses, Senator Marco Rubio (R-Fla.) introduced a bill in January 2019 that would ban non-competes only for low-wage employees. That too did not appear to garner support.

2019 Workforce Mobility Act

On October 17, 2019, Senators Murphy and Young introduced the 2019 Act, which is slightly more moderate than the failed 2018 Act. The new bill proposes to ban all non-compete agreements generally, except for those associated with the sale of a business or the dissolution of or disassociation from a partnership (as long as the surviving entity continues to carry on a like business after the sale or dissolution). Even in those situations, the bill strictly limits the use of non-competes. For example, in the sale of a business, the buyer may enter into non-competes only with: (i) the seller; and (ii) senior executives who were employed at the time of the sale and are subject to severance agreements that require payment to the executive, upon termination, of an amount equal to or greater than the total compensation the executive would reasonably be expected to receive in the year following the sale.

The 2019 Act also would limit the extent to which a non-compete may restrict a party's future business opportunities. First, the non-compete restrictions may not exceed one year in duration. Second, the non-compete may only prevent the restricted party "from carrying on a like business" within the same geographic area in which the business operated prior to the sale, dissolution, or disassociation. Although the 2019 Act does not define "carrying on a like business," this language could be interpreted to mean that a non-compete may prevent the restricted party from *owning,* but not from *working* for, a competing business.

The 2019 Act would require all employers to post notice of the law's requirements in a conspicuous place. It would empower the Federal Trade Commission and Department of Labor to jointly enforce the law's requirements. The agencies would be able to issue civil penalties and pursue judicial action on behalf of aggrieved parties. Aggrieved individuals would be afforded a private right of action to seek actual damages for violations, as well as for costs and reasonable attorneys' fees.

Finally, the 2019 Act defines a "non-compete agreement" as an agreement that "restricts" a worker in his or her ability to perform "any [similar] work" for a specified period of time, and in a specified geographic area, after the working relationship ends. Although the 2019 Act states that it would not prevent a business from contracting with a worker to not disclose trade secrets, it does not state whether "non-compete agreement" would cover other restrictive covenants, such as customer non-solicitation and employee non-solicitation

covenants and non-disclosure agreements for the protection of confidential information that falls short of being a trade secret.

2019 Act Findings

The 2019 Act lists "findings" that paint non-compete agreements as deeply damaging to worker opportunity, as well as unnecessary to protect a company's legitimate business interests. Among other criticisms, the Act asserts:

- Non-competes "are blunt instruments that crudely protect employer interests and place a drag on national productivity by forcing covered workers to either idle for long periods of time or leave the industries where they have honed their skills altogether";
- Non-competes "reduce wages, restrict worker mobility, impinge on worker freedoms …, and slow the pace of American innovation";
- Businesses are fully capable of protecting their legitimate interests through less intrusive measures, including by availing themselves of "trade secret protections, intellectual property protections, and non-disclosure agreements"; and
- Non-competes are counter-productive to the goal of "[f]ostering an environment where employers can flourish[.]"

The bill's critical "findings" are similar to the complaints about non-competes cited in a March 7, 2019, letter in which the Act's sponsors and other Senators asked the Government Accountability Office to investigate and report to Congress on the use and abuse of non-compete agreements in the United States. No report has been issued, and it is unclear whether the bill was based on any new evidence.

Trends in States

Many state governments recently enacted laws that regulate non-competes without broadly banning them. For instance, state laws passed in the past two years:

- Ban non-competes for lower-income workers (Maine, Maryland, New Hampshire, Rhode Island, Washington);
- Ban non-competes for employees who are non-exempt under the Fair Labor Standards Act (Massachusetts, Rhode Island);
- Impose notice requirements that reduce the likelihood an employee will be surprised with a non-compete requirement after he or she has left a previous job (Maine, Massachusetts, Washington);
- Prohibit enforcement of non-competes against workers who have been laid off or otherwise discharged without cause (Massachusetts); and
- Require employers to continue paying laid off workers during the post-employment restricted period (Washington).

These state measures largely align with the recommendations in the Obama Administration's Call to Action. The 2019 Act would essentially nullify those measures.

Going Beyond the Call to Action

Although the 2019 Act does not reference the Call to Action, it rejects the validity of limited reform. It argues that employers can fully protect their legitimate business interests through existing trade secret laws. This is debatable. When an employee joins a competitor, the former employer is significantly limited in its ability to monitor whether the employee is using its proprietary information on behalf of the competitor. Moreover, other vital business interests beyond trade secrets (including client relationships, goodwill in the community,

and confidential information that falls short of constituting a trade secret) that cannot be safeguarded sufficiently through statutory or contractual trade secret protections.

Some may prefer a uniform federal non-compete ban to a patchwork of state laws that vary widely in the degree to which they protect the interests of employers and workers. However, safeguards against employer abuse of non-competes already exist in the court system, where employers must prove a non-compete is reasonable in time and scope and narrowly tailored to protect the employer's legitimate, protectable business interests.

What Happens Next

The Senate Committee on Small Business and Entrepreneurship held a hearing on the 2019 Act on November 14, 2019. While a majority of the participating Senators appeared open to federal non-compete reform, approval of a broad ban is unlikely. The 2019 Act's sponsors may see their proposal as the first step in negotiating a compromise bill that might more closely resemble enacted state laws, should there be interest or ability in Congress to move this bill forward.

We will monitor any developments with the 2019 Act and provide updates. Subscribe to our Non-Compete and Trade Secrets Report blog for updates. Employers with questions about the lawfulness of their restrictive covenant agreements are encouraged to contact a Jackson Lewis attorney.