Increased Government Pressure a Threat to State Non-Compete Laws?

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Some uninvited guests have shown up to the party and are starting to create a scene. Just days after calling on the Government Accountability Office to conduct a federal investigation into the effect of non-compete clauses in employment contracts, federal legislators are now asking the U.S. Federal Trade Commission to take action following a petition urging the agency to issue a rule prohibiting employers from requiring that their workers sign non-compete agreements.

The enforceability and validity of non-compete agreements have historically been within the realm of state law. Different standards of review across state lines in evaluating these agreements typically depend on the development of case law or the outcome of legislative initiatives. So just how did the federal government get news of the party? They received a not-so-anonymous tip from none other than sandwich chain Jimmy John's! In the aftermath of the now-infamous Jimmy John's non-compete saga, there continues to be a growing effort among federal legislators to unnecessarily intervene and impose a nationwide ban on non-compete agreements.

Jimmy John's Sparks Initiatives for Change

Several years ago, a national debate on the appropriateness of non-compete clauses in employment contracts was sparked after it was publicized that Jimmy John's was requiring its sandwich makers and delivery drivers to sign broad, two-year non-compete agreements that precluded those employees from leaving to work for nearby competitors. After much criticism and other pressures, Jimmy John's ultimately backed off and agreed to stop including non-compete clauses in its hiring documents and to rescind existing non-compete agreements.

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The decision by Jimmy John's to back off was the right one but scrutiny over the use of non-compete clauses in employment contracts only began to intensify following the initial backlash. In October 2016, the White House, under the Obama administration, issued a "call to action" encouraging states to, among other things, pass legislation banning non-compete clauses in contracts for certain categories of workers such as those who i) fall below certain wage thresholds, ii) likely do not possess trade secrets, iii) work in occupations related to public health and safety, or iv) would suffer "undue adverse impacts," such as workers who were laid off or terminated without cause.

States Begin to Revise Non-Compete Laws

Following the White House's "call to action," some states sought to limit enforcement of restrictive covenants, or make certain types of them illegal outright, and frequently made Jimmy John's the poster child for those efforts. For example:

- Illinois enacted the Illinois Freedom to Work Act, 820 ILCS 90, which prohibited the use of non-compete agreements for employees who earn $13 an hour or less.
- In Nevada, Assembly Bill 276 significantly changed Nevada's law on restrictive covenants by adding new requirements to the enforceability and validity of non-compete agreements, and allowing courts to "blue pencil" (i.e. revise) non-compete agreements.
- The Massachusetts legislature recently enacted the "Massachusetts Noncompetition Agreement Act" - a comprehensive non-compete reform law regulating non-competes, limiting their enforceability, and codifying express requirements they must meet.

By all indications, other states seem poised to follow the trend. Already this year, three states have proposed legislation on the issue:

- The Vermont Legislature started 2019 by introducing Bill H.1 which seeks to prohibit all non-compete agreements in the employment context.
- On February 21, 2019, the New Hampshire Senate approved Senate Bill 197 which, similar to the Illinois Freedom to Work Act, prohibits employers from requiring low-wage workers to enter into non-compete agreements, and makes such agreements void and unenforceable.
- In early March, the Washington Senate approved a bill that seeks to ban non-compete agreements for workers in the state with the exception for employees making more than $100,000 per year.

Based on the foregoing trends, it is highly likely that other states will follow suit in 2019 or renew previous efforts to legislate change.

U.S. Senators Crash the Party

Not to be outdone by their state counterparts, federal legislators have also tried to weigh in on the issue in hopes of enacting federal non-compete legislation. Last year, Democratic U.S. Senators Elizabeth Warren (D-Mass.), Chris Murphy (D-Conn.), and Ron Wyden (D-Ore.) introduced the "Workforce Mobility Act" seeking to prohibit the use of non-compete agreements nationwide. This year,

U.S. Senator Marco Rubio (R-Fl.) recently introduced the "Freedom to Compete Act" proposing to amend the Fair Labor Standards Act (FLSA) of 1938 to ban non-competes for most non-exempt workers. The broadly drafted Act seeks to preclude employers from entering into non-compete or other restrictive covenant agreements with low wage workers, and seeks to invalidate existing employment agreements entered into before its enactment.

Pressure from and to federal agencies on the subject continues to increase in the wake of these recent legislative efforts. On March 7, 2019, the federal legislators identified above along with two other U.S. Senators submitted a letter to the Government Accountability Office requesting a federal investigation into the effects of non-compete agreements on workers and on the economy as a whole over concerns that their wide-scale use "could slow economic and wage growth, reduce productivity and competition in labor markers, and create significant barriers to entrepreneurship and innovation."

More concerning, several labor and advocacy groups, among others, have now submitted a petition urging the FTC to issue a new rule prohibiting employers across industries from requiring that their workers sign agreements limiting them from going to work for a competitor. The petition even references the Jimmy John's non-compete. In a letter to the FTC, seven Democratic U.S. Senators weighed in by praising the petition and requested that the FTC respond within 30 days with any action it is taking to curtail non-compete clauses, adding: "[i]t is not enough that the Federal Trade Commission shares our concerns about these actions. It must act decisively to address them." The FTC has not yet responded.

Whether by federal legislation, investigation, or agency rule, any attempt to impose nationwide laws and/or rules regarding the validity of non-competes are unnecessary and interfere with states' rights to tailor laws on the issue as they see fit. After all, only California, Oklahoma, and North Dakota ban the use of employee non-competes. Every other state allows employee non-competes to some extent and deference should be given to each state to craft non-compete laws that balance the interests of employees with the legitimate business interests of the companies who employ them along with other considerations.

What Can You Do While Awaiting the Outcome of these Federal Efforts?

For most employers, non-compete agreements should be limited to workers with a true ability to harm the company through unrestricted competition. But in most states, non-compete clauses can only be used to protect an employer's legitimate business interest and must be reasonably limited in terms of duration, geography, and scope of activity. If companies try to impose unreasonable non-compete clauses on their workers, they would likely face scrutiny in both the court of public opinion and the court of law. And as pointed out above, such overzealousness by employers could have blowback, causing legislators (state or federal) to act where they otherwise have not. When considering the use of non-compete clauses in employment contracts, employers should carefully consider which employees truly pose a risk to their business interests, and to consider the current state of the law in the states those employees operate in.