The Employment Law Counselor hosted by Jeff Stewart Episode 12

PLUS Staff: [00:00:00] Welcome to this PLUS Podcast, the Employment Law Counselor hosted by Jeff Stewart. Before we get started, we'd like to remind everyone that the information and opinions expressed by our speakers today are their own, and do not necessarily represent the views of their employers, or of PLUS. The contents of these materials may not be relied upon as legal advice.

Jeff Stewart: Hello everyone and welcome to the Employment Law Counselor Podcast. I'm your host, Jeff Stewart, and today we'll be talking about the future of non-compete agreements, a topic that has certainly been in the news over the past few months. This podcast is a collaboration between White and Williams LLP and Professional Liability Underwriting Society, commonly referred to as PLUS.

While our podcast is not legal advice, it is a practical discussion between two attorneys that deal with the maze and minefield of labor and employment laws on a daily basis. If you like what you hear, please give us a five-star review and subscribe so you never miss an episode. Today, I'm joined by one of my colleagues here at White and Williams, Scott Kasher, who practices out of our firm's Stanford, [00:01:00] Connecticut office.

Jeff Stewart: How are you doing today, Scott?

Scott Casher: I'm doing great. Jeff, how are you doing?

Jeff Stewart: I'm doing great. And this is your first time on the podcast. So welcome.

Scott Casher: Thanks. Not only first time on this podcast, it's the first time on any podcast.

Jeff Stewart: Oh, well, we're honored to have you here on the Employment Law Counselor Podcast.

This is great. So why don't we just dive right in? Today we're talking about non-compete agreements. And Scott, you've actually done a little bit of history into non-compete agreements. Where did they start?

Scott Casher: I have. I have. Yeah. I litigated in this area a lot. In Connecticut, which as you mentioned is my home base, but also in New York and New Jersey.

Yeah. So little, little history lesson here about non-competes, but really why we're here, Jeff is because of the FTC's new rule, right? That is looking to ban non-competes and it's gotten a lot of attention from a lot of people in the business community who are concerned about it. So non[00:02:00]-competes date back basically till about the 15th century, English common law, and there were court decisions from back then that banned them, and then permitted them, and a lot of that law ended up forming the basis of the law in the U.S. in states in the 16th, 17th, 18th century.

Jeff Stewart: And when we're talking non-competes, I think it's probably good for any of our listeners who may not be familiar with them to just give kind of a general explanation. A non-compete agreement is essentially an agreement between an employer and an employee that says when you leave working for us, you cannot go to a competitor.

Generally, it's for a specific amount of time, within a specific distance, or potentially it's within a specific industry if they have specialized knowledge. And these are agreements that, frankly, have become much more common than they were 30, 40 years ago. And I think that's one of the reasons that the [00:03:00] Federal Trade Commission, the FTC, feels the need to step in.

Would you agree with that, Scott?

Scott Casher: Yeah, I think that that's right. But I think, really, the concern by the FTC, and we'll get into this in a little bit, Jeff, but it really stems from different legislative reports, congressional reports, reports from different administrations that started looking at these non-competes particularly for lower earning workers. That was the concern.

I don't think the government has ever really been concerned about the executive non-competes, right? The high earning people, the people who are privy to a lot of sensitive financial information, sensitive intellectual property, right? I think the government, even the federal government recognizes that.

That deserves protection for businesses. I think what their concern was, these non-competes were being abused in their view by certain businesses when they were having people like sandwich makers [00:04:00] and hairstylists, and, you

know, hourly workers who had to sign these non-competes and then couldn't go across the street from McDonald's to Burger King to work.

I mean, it's absurd, frankly. And so, I think the federal government stepped in and we'll talk about the states too, but states really started this, you know, they started stepping in, putting in income threshold bands, right? That if you made less than a certain amount, you were not going to be subject to a non-compete and that makes sense to me.

Jeff Stewart: And let's talk about some of those states and some of those state issues, because really, it has been for my entire lifetime and, you know, it has really been a patchwork of rules depending on what state you're in. And when I began my practice of law and looking at non-compete, you know, one of the keys is what is the choice of law provision in a non-compete because where I practice in Pennsylvania is very different than New Jersey or New York where I've also [00:05:00] had cases.

You know, it really depends on what your state would deem reasonable and enforceable.

Scott Casher: Yeah, I think that that's right. And you know, generally most states, at least up until maybe the 20th century, all looked at sort of the same general factors, right? And I'm just making a generalization here when examining whether a non-compete was going to be enforceable or not, right?

So, it would look to the purpose of the non-compete, the geographic scope that you mentioned, Jeff, right? The length, a year, two, three, four, five, right? And what kinds of things it blocked the worker from doing. Right. And if all those things were reasonable in the court's mind, then it would be enforced. If it wasn't, it wouldn't be.

But then things started to change in California is probably the most famous state, right? Banning non-competes really, and banning a lot of restrictions on employees that leave their employment. But now we've got some other [00:06:00] states. And so, I would say in the last seven or eight years, there've been a number of states that started restricting non-competes for lower earning workers. Which we just talked about some states now require that employees be given advanced notice about non-competes.

And I think that there are other reforms, even legislative reforms that are happening in a number of states right now. So, there's a chipping away at the

non-competes, but again, I think a lot of it is for protection of lower wage workers, for the most part.

Jeff Stewart: I agree, and actually I think that is well illustrated by what happened in New York earlier this year. New York's legislature passed a universal ban on non-compete agreements. And the governor vetoed it, but when the governor vetoed it, she said, "look, there's no exception here for your high wage earners, which I think should be covered under non-competes at times because they have certain specialized [00:07:00] information, specialized access to things that your hourly worker doesn't."

So, she basically said "legislature, you give me something that bans non-competes, but has an exception to allow them for your high wage earners, and I'll sign that." And we're waiting for that to happen, but I think that is likely to happen in the next six to nine months.

Scott Casher: I, I think that that's right. And so, even before we get to New York, which I want to talk about, you know, a little bit, we've got, right now, ten states that have no restrictions on non-competes.

We may see that changing in the next couple of years. We've got about four States that have a complete ban on the use of non-competes. And then the rest of the States are sort of influx. There are some restrictions. There's some legislative activity. As you mentioned, New York is one of them.

And right after governor Holkel in New York vetoed that [00:08:00] legislation, the New York City council. So that would apply to businesses and workers in New York City.

They're not going to wait around for the governor and, and legislators in Albany to act. And that's pretty typical, you know, in New York and New York City where I practice, the New York City council is pretty active and they'll get ahead of Albany if they think that something needs to get done. So, we're keeping an eye on that as well.

Jeff Stewart: Definitely. So with that as kind of the background of where things have been at the state level and, and from a historical perspective, let's talk about the Federal Trade Commission, which, you know, we've been talking about this proposed non-compete ban for a while, because it was actually January of 2023 that they released a proposed rule to essentially void existing non-competes, but they didn't vote on that proposal until after they received [00:09:00] public comments, et cetera.

And they finally voted on it in April of this year. And that's when we saw a whole plethora of newspaper articles and I'm dating myself when I say newspaper articles, articles on the web, and, you know, on television and everywhere talking about these non-competes ban that they have proposed, which is now set to go into effect September four of 2024.

Scott, before we talk about the legal challenges, which we're going to get to later, can you kind of give our listeners a bit of the specifics of the ban?

Scott Casher: Yeah, I will do that. And Jeff, before I do that, I want to give people a little bit of sort of a historical backdrop on what's been going on in Washington DC because this didn't come out of nowhere, you know, in January of 2023.

So, as you said, the proposed rule comes out in [00:10:00] January 2023. And now we've got this final rule that's being challenged, hasn't gone into effect yet that came out in April, basically banning all employment non-competes. We're not talking about sale of business, just the employment contact. But going back about 10 years, there was a famous case involving a sandwich shop called Jimmy John's and Jimmy John's had non-competes for their sandwich workers.

And when the media got ahold of this, there was sort of a firestorm because it seemed ridiculous, right? Are you kidding me? You're going to prevent a sandwich worker from, you know, when he leaves Jimmy John's from going across the street and working at Sal's Sandwich Shop? I mean, it seemed kind of crazy, but that case got a lot of people's attention in Washington.

And so, some legislation started being proposed in 2015. It was the Move Act of the following year, the Obama administration started doing some studies and issuing reports. 2018, there was more legislation that was proposed, [00:11:00] 2019, the same thing, but none of those bills passed.

Right. So, there was this sort of frenzy of activity for the last five or six years. Well, from 2015 to we'll say 2020, right, but Congress didn't get anything passed. So, I think what happened, Jeff, is that the Biden administration wanted some action and basically said to the FTC, you take it because we can't get it done in Congress.

Jeff Stewart: And that we'll talk about in a few minutes, that is the substance of some of these appeal or some of the challenges from a legal standpoint is that whether or not the FTC has the power to enforce this kind of a ban or whether it requires legislative action from Congress to do anything like this, right?

Scott Casher: That's right. So, you know, going back then, January 2023, after it was clear that Congress wasn't going to be [00:12:00] able to get anything done here, the FTC puts out its proposed rule, and there was just an incredible amount of opposition to it. There was a long public comment period. I think there were close to 20,000 comments that were submitted, business associations and so forth.

And the real concern was the disruption to existing contracts, disruption to this long history of state law, the fed stepping in an area where they really shouldn't be, whether or not they have the power to do so. And that was a lot of the opposition. And I think that's why it took so long, Jeff, for the FTC to issue its final rule, right? It was almost a year and a half in between the proposed rule and the final rule.

Jeff Stewart: Absolutely. And there were one or two key changes. Once it went to a final rule, for example, one that you mentioned briefly there is they made sure to allow for non-competes in the sale of a business and said, [00:13:00] "look, we're not messing with that."

And when you think about it, that makes sense. If I sell you my bakery, let's say I shouldn't be able to open up a bakery literally next door because you know, the person who bought it, they are expecting me, and usually it's a term of the sale agreement to stay out of the bakery business and compete with what I just sold.

So that makes perfect sense. And that's one area where you say, okay, good. They listen to public comment, but there are a lot of areas that frankly, I think are still troubling to a large part of the business community.

Scott Casher: I think that's right. So, there is an exception for the sale of the business. Another interesting change from the proposed rule, Jeff, to the final rule is in the proposed rule, it required 25 percent ownership in order for a non-compete to be enforceable, right? So, if there was less than 25 percent ownership, they wouldn't permit it. They got rid of that in the final rule. So now there [00:14:00] is no such requirement. There's an exception for senior executives, right?

So, it's not going to apply to senior executives, even in the employment context. And I think that supports what we were talking about earlier in the podcast, that really this rule is aimed at protecting, you know, lower wage workers, but you're right. There's a lot that stayed in between the proposed rule and the final rule.

And I know that the concern from a lot of our clients is that this is not only going to apply to non-competes. This final rule, if it isn't successfully challenged, and we'll talk about that litigation in a minute, could impact non-disclosure agreements, could impact traditional non-solicitation agreements.

Those agreements that say, you can go and compete, just you can't steal our customers and bring them with you. You can't steal our employees and bring them with you. The way that the final rule is written, it's broad enough, I [00:15:00] think, for creative attorneys on the other side to make the argument. That a non-solicit might be banned here, that a non-disclosure agreement might be banned here.

And that's a big concern.

Jeff Stewart: Absolutely. Now, one of the other things is that this ban doesn't just go forward. It says, "okay, we don't care if you entered into a non-compete agreement a year ago, five years ago, we are declaring it null and void. We don't care if you paid $10,000 in consideration to the employee.

Guess what? That agreement is now void. They kept the money and now you get no benefit." And that is something that I think a number of businesses have a fundamental problem.

Scott Casher: Yeah. I mean, it's the federal government coming in and saying, "we're going to tear up your contracts, right? We don't care that you bargained for this two years ago, five years ago, 10 years ago. We don't care what the provisions are in that [00:16:00] agreement, what the employee got, what you got, we're just saying it's now banned."

I don't think we've ever seen that kind of overreach that I'm aware of by a federal agency.

Jeff Stewart: And not just that it's banned and that it is unenforceable. They're saying, "employer, you have to give them notice that it is unenforceable and that they're able to go wherever they want to and do whatever they want to do." Which is a whole other avenue of problems, because I know a number of my clients and Scott, I'm assuming a number of yours as well have employees enter into non-compete agreements with perhaps never the intention to enforce them.

That they act as a deterrent because the employee will say, okay, well, I know I've got this issue. I don't want to roll the dice as to whether or not my employer is going to try and enforce it. I'm not even going to go in that direction. I'm

going to go somewhere else. Okay. And then the employer doesn't have to worry about it.

And in fact, I had a client [00:17:00] that would not enforce their non-competes if somebody went to a competitor, but they would enforce them if they were trying to start their own business and essentially creating a new competitor in that space. But by having this notice that you have to say, you're free to go do whatever it is you want to do, gets rid of that deterrent as well.

Scott Casher: Completely. But I think the reality, Jeff, is that everybody is aware of this. It is in the news so much. That this isn't something that's a secret to anyone, but I agree with you about the notice provision. I want to say one other thing, just to go back to the senior executives. I don't want people to be left with the impression that if you're just a senior executive, you're somehow exempted from this rule.

If it goes into effect, that's not the case, right? So, there's two prongs that have to be met under this rule in order for you to qualify as a "senior executive." Yep. One is that you're making at least $151,000 in the [00:18:00] preceding year. That's not going to be that hard, right? You have a lot of middle management and on up who are making that, you know, any good size city, right?

But the other prong is the prong that I think is going to be a little bit tougher. And that's, you not only have to be making $151,000 in the preceding year, you have to be in a "policy making position." What does that mean? You could be a Vice President. You could be in some other director, some other very high position in a company.

But you have nothing to do with policy. You don't drive the policy of the company. You don't vote on the policy of the company. You don't, no one cares about your opinion on the policy of the company. Right. And under this rule, the way it's written, you would not be a senior exec. So again, I think there's sort of a minefield here.

It's just, there's a lack of clarity and I think there are potential problems, and it will lead to a lot of litigation, you know, particularly over provisions like [00:19:00] this.

Jeff Stewart: Absolutely. It will. And the other thing I just want to put out here for our listeners is we talked earlier about states and having different rules, et cetera.

This FTC ban has a specific supremacy clause that says, “look, we don't care what your states say. This is now the law of the land. Period. End of discussion. This is it. So, state rules, whatever, ignore those. We are now the governing body and we are telling you what it is.”

Scott Casher: And that sort of dovetails nicely, Jeff, into some of these legal challenges that are going on, because that's one of the main arguments.

So, there are a couple of cases I'll just talk about, you know, very quickly. So, there was the Ryan case, and that was the first case that was filed in federal court in the Northern District of Texas. Then there was a second case filed in the Eastern [00:20:00] District of Texas. That was Chamber of Commerce of the U.S. versus the FTC, but that was stayed because of the Ryan case was filed first, so nothing's going on in that second one.

And then there's a third case that was filed in the Eastern District of Pennsylvania. That's the ATS Tree Service versus FTC case. That one's moving along a little bit more slowly than the Ryan case.

So, the Ryan case is really the one that everyone's watching. And the court is going to issue a decision on July 3rd on Ryan's motion for an injunction and a stay, and I'll talk about, you know, a little bit more detail there, but essentially the plaintiff in that case, Ryan LLC is arguing. So, the court is for all these legal reasons that we'll talk about in a minute, the court should enjoin the FTC from enforcing this rule on September 4th, which is the date that it's set to take effect.

Alternatively, Ryan is saying to the court, if you're not willing to [00:21:00] enjoin it, you should stay enforcement of it while we take this up on appeal and it would be to the fifth circuit, which is the appellate circuit for Texas, which I think would be a pretty receptive circuit. You know, to these arguments, so all the papers have been filed on both sides, motion for an injunction, opposition, reply, brief, right?

Court decided it did not need a live hearing on a preliminary injunction hearing. Court said, “I'm going to just rule on the papers, which suggests that this is just purely a legal issue.” And it did say it's going to issue a decision on July 3rd.

Jeff Stewart: And what I find interesting is in looking at all of these challenges, I would say a majority of the challenge is on whether the FTC even had the authority to issue such a rule as opposed to the substance of any of the rule itself.

Scott Casher: That's right. And you know, Jeff, that the Supreme Court over the last [00:22:00] decade or so has been chipping away, you know, at the Chevron decision, which was the decision, you know, we all learned about in law school and it was the law of the land for so long where the federal courts would be deferential to agency determinations.

And that really started to shift with the court over the last decade. And the court has said, "you know what, these agencies have limited powers. They can't just issue rules that impact, in this case, you know, the states that impact other law, other legislation." And they're starting to strike down, you know, some of these rules that are being issued by different agencies, whether it's the EPA, whether it's the FTC.

And I think that Ryan, you know, the lead plaintiff in this case in Texas, is going to have a very receptive audience if the case gets up to the Supreme Court and it may, it may not right with the change in administration after the election, who [00:23:00] knows, you know, if the government loses, if the FTC loses and there's a change in administration, they may not pursue an appeal.

Jeff Stewart: Absolutely. And the other thing that I think is very relevant is some of what you talked about earlier. The fact that there was attempted legislation to do this that never got passed. This is not something that, you know, Congress has never taken up. No, Congress took it up and decided not to pass something like this.

So, you know, essentially, what the plaintiff is alleging is that the Biden administration through the FTC is doing an end around Congress. And is that appropriate? And I think that is really the issue that is going to be decided here. And make no mistake, the plaintiffs in this matter chose Texas for a reason.

This is the exact same forum that they challenged changes to the Fair Labor Standards Act back in 2015 now, [00:24:00] and ended up with a nationwide injunction of those new regular proposed new regulations at the end of the Obama administration. So, they pulled the same play out of the playbook and said, "we want to go to this court in Texas. And let's see if we can get this stopped before it can be enforced."

Scott Casher: I think that's exactly right. And that is the argument that's in the Ryan case and the ATS case, the chamber of commerce case, they're all coordinated. I mean, this litigation is coordinated between all these parties and business groups.

So the arguments are the same. And it's, you know, as you said, Jeff, that the first main argument is the final rules of violation of the major questions doctrine, because Congress didn't provide clear direct authority for the FTC to issue this kind of rule. You know, the second argument is this rule violates the non-delegation doctrine.

That is, even if the FTC had authority to promulgate the final rule. And as you said, and I think this is going to be a big point for the court, [00:25:00] Congress over five or six years introduced a bunch of legislation, and nothing got passed. And I think the court's going to be pretty persuaded, you know, by that, that the FTC now can't just step in and take over from that.

The final argument, which I'm not sure has as much strength, but it's appealing is that the final rules, arbitrary and capricious, that is that the FTC failed to take into account the vast economic impact that this rule is going to have on businesses throughout the country, including lost prior expectations and consideration that are provided for an existing non-competes.

What we were talking about before, employers may have given these employees extra compensation, you know, or other things of value to the detriment of the company. And now the company is losing all that.

Jeff Stewart: So Scott, I know I've been asked and I'm sure you have as well. Once news of this came out, what should an employer do now?

Because right now we're in [00:26:00] kind of this gray area. And personally, I do not think that come September four, this rule is going to be enforced. I think it is going to be stopped by the courts. That doesn't mean employers should just do nothing. So, what have you been advising your clients to do?

Scott Casher: I agree, Jeff, I've said the same thing.

You know, my personal view is that it's pretty unlikely that the court is going to permit this rule to go into effect. And I think actually, even if the district court did rule in favor of the FTC, again, unlikely, I think the district court would grant Ryan a stay while Ryan appeals to the fifth circuit.

So, in any event, the rule wouldn't go into effect until the litigation makes its way all the way up to the Supreme court, who knows, right? Judges do crazy things. So, I have been having conversations with employers that they need to be prepared. They can't just keep their fingers crossed and hope that

I'm going to be [00:27:00] right or that they're going to be right. They need to be prepared. So, the first thing that they should be doing is auditing their agreements and thinking about alternatives, right? So, you want to be looking at how many non-competes do you really have out there? What do those non-competes look like, who are they with?

Are there people that fall into the senior executive category? That policy making with the right salary threshold, put those people in one bucket, right, and feel pretty confident that won't be an impact there. What about all the other people, right? I think you have to be prepared that it's possible that those non-competes go away.

Now, what other protections do you have in place that would be compliant with the rule if it goes into effect? Non-disclosure agreements, non-solicitation agreements, right? Come up with alternatives so that you do have adequate protection for your business, for your intellectual property in the event that these non competes go out the window.

Jeff Stewart: Absolutely. And a [00:28:00] traditional confidentiality agreement is another very crucial piece that I advise employers. Look, just having a confidentiality policy in your handbook, that's one thing. But actually having each employee sign a confidentiality agreement that if they leave, they're not using any of your information to benefit a competitor, et cetera.

That's not a non-compete agreement. It's a confidentiality agreement. And that's going to be enforceable regardless of the outcome of this FTC ban.

Scott Casher: I think that that's right. The final thing, you know, Jeff, as you mentioned before about this notice requirement, there is a sample notice form that the FTC has provided in conjunction with the rule, employers should take a look at that and be prepared.

Don't wait until September 3rd, have some form of notice that's compliant with that form, ready to go if you do need to send it out. And again, the list of people to whom you have to send it.

Jeff Stewart: All right. Well, Scott, I want to thank you for joining me here today, [00:29:00] but I always like to give our listeners one or two key takeaways from our discussion.

So, you know, do you have a key takeaway to give to our listeners?

Scott Casher: You know, I would say two things. One is keep an eye on the Ryan case, because I think that businesses will be guided by what happens there, but don't wait until September 3rd to take action. So again, take a look at your agreements, make sure you're organized about it, get your notice in place.

And come up with some other form of agreements, confidentiality agreements, non-disclosure agreements, non-solicitation, so that your business is adequately protected. And of course, you know, consult with your council and have your council help you through this.

And I guess I would throw in one or two more, which is first off, watch what your state is doing with non-competes because, as Scott and I indicated, we think there's a long way to go [00:30:00] before this FTC ban would go into place, if it ever does. However, right now, it is your state that is controlling. And because of this FTC ban announcement, a number of states are taking steps to ban them themselves. And, even if the FTC ban would get struck down, the state could, if they have a ban, that could be in place.

So, you need to prepare your business for that and keep an eye on that.

Scott Casher: Great point, Jeff.

Jeff Stewart: Well, with that, I'm going to thank you, Scott, for joining me. And I want to thank all of you listeners for joining us here on the Employment Law Counselor Podcast, where we try to make sense of the world of labor and employment law.

On behalf of myself and Scott Kasher, we thank you for listening. If you enjoyed this episode, please leave us a 5-star review, tell your friends, and subscribe to the podcast. For more information on this and many other topics, please visit the White and Williams website at [00:31:00] www.whiteandwilliams.com, where you can visit our blog and learn more about the firm.

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