Businesses Have About a Month Left to Submit Comments on the FTC's Proposed Non-Compete Clause Rule

Insights
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Employers have about a month left if they want to submit a formal comment to the federal government about the proposal that would ban most noncompetition agreements and force you to rescind existing agreements – but should you? And what would you say? The Federal Trade Commission's current deadline for such comments is March 20. What do employers need to know in advance of this impending date?

What is Happening?

For those unfamiliar, the Federal Trade Commission (FTC) proposed a rule that would render non-competition agreements as "an unfair method of competition – and therefore a violation of Section 5 of the Federal Trade Commission Act." It would make unlawful the vast majority of non-competition agreements currently in effect, including those that are compliant with state laws permitting non-compete agreements. And it would also force employers to rescind existing agreements. To read more about this broad proposal, check out our FAQs here.

If your business uses non-compete agreements, then you may want to consider submitting a comment to the FTC – or joining with business associations to submit a comment – by the March 20 deadline. If so, what would you say?

Many states have enacted specific statutes governing the use of non-compete agreements within limits. For example, some state laws do not permit non-compete agreements for physicians and nurses or other particular professions. Other state laws do not permit non-compete agreements to be implemented against lower wage earners.

Regardless of whether or not there are state statutes in place, the court systems in every state have developed bodies of authority refining and limiting the extent to which a non-compete agreement can be enforced. These authorities provide for a weighing of the factors with protection of a company's goodwill, key client relationships, and confidential information on one side and workers' opportunities for gainful employment on the other. The following brief review of Kentucky's case law, as an example, demonstrates how a typical state's courts balance and weigh these factors.

Key Question: What is a Businesses' "Goodwill"?

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One of the first questions that often needs to be answered when balancing these factors is the definition of "goodwill" in each state. Goodwill has been defined in Kentucky as "the probability that the old customers will resort to the old place." In other words, goodwill "is the expectation that patrons or patients will return because of the reputation or business of the firm."

In discussing the valuation of goodwill, the Kentucky Supreme Court has remarked that goodwill "is premised on the notion that the reputation of the business will draw customers, get them to return and thus contribute to future profitability." It is maintained through the active pursuit and cultivation of client relationships over an extended period of time. As such, Kentucky courts have recognized goodwill to be a valuable property right entitled to protection.

The Sixth Circuit Court of Appeals – which is the federal appellate court for federal courts in Kentucky, Ohio, Michigan, and Tennessee – has also recognized that "the loss of customer goodwill often amounts to irreparable injury because the damages flowing from such losses are difficult to compute." In a key 1992 case, that appellate court affirmed an injunction entered by the district court in part because the evidence showed that defendants had access to confidential customer information, removed much of this information when they left for a new employer, and promptly began contacting the former employer's customers. Also, the defendants had access to the former employer's pricing information and could use that information to underbid the former employer.

Basic Reasoning for Enforcing Noncompetition Agreements

In a 1978 case, the Court of Appeals of Kentucky affirmed the enforcement of a non-compete agreement, in part, to protect an employer's goodwill. Specifically, Big Sandy, an insurance claims company, sued one of its former claims adjusters after he began his own company and actively solicited Big Sandy's clients to sell insurance policies. The claims adjuster challenged his employment agreement, which prohibited him from engaging in the adjustment of certain insurance claims and services within a 200-mile radius of any territory served by Big Sandy for one year. The court's rationale for its holding is succinctly stated as follows:

> In this case, Big Sandy had a legitimate concern in protecting itself from the very situation which arose in this case. An adjustment service has to spend much time and money to generate good will among the insurance agencies and companies in the area it services. A company like Big Sandy is particularly vulnerable to solicitation by employees or former employees of business from its clientele. Hammons, as well as other employees, could use their positions inside the company to undermine Big Sandy's position with its clients. A covenant, such as the one at bar, not to engage in competition is a valuable business tool and it did not work an undue hardship on Hammons or the public. An insurance adjusting office must depend on a large surrounding area in which to sustain itself in business. It was not an unreasonable restriction by the trial court to restrict his business within 200 miles of Middlesboro when you consider the nature of the business. It is to be born in mind that the covenant herein did not prevent Hammons from working as a staff adjuster (on salary) in the

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area for any insurance company. He was only restricted from entering into direct competition with Big Sandy for one year.

Thus, this opinion provides an example of the balancing of these factors, which in this case, favored the enforcement of this non-compete agreement. There are, of course, many other opinions, in which, under different facts and circumstances, courts across the country balance these factors and found the non-compete unenforceable.

How to Make a Comment

The FTC's proposed rule, however, would remove just about any opportunity for a court to weigh these factors in reaching a decision. For this reason, you may want to consider weighing in with your business considerations.

As noted above, the agency permits comments on this proposed rule by March 20. Online submissions may be filed on the federal government's website. You may want to submit a comment or work with other companies and business organizations to submit a joint comment. All comments will be placed on a publicly accessible website. For this reason, you should ensure that your comment does not include any sensitive or confidential information.

Conclusion

We will continue to monitor the latest developments and provide updates as warranted, so you should ensure you are subscribed to Fisher Phillips' Insight system to gather the most up-to-date information directly to your inbox. If you have questions, please contact the author of this Insight, your Fisher Phillips attorney, or any attorney in our Employee Defection and Trade Secrets Practice Group.

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