The White House is Interested in Non-Compete Reform

Insights
5.06.16

President Obama is expected to sign the Defend Trade Secrets Act, which passed with overwhelming, bipartisan support in the House and Senate in recent weeks (and about which we will have a lot more to say in the coming days). Now, his Administration is moving from one major arena in which companies protect their confidential information to the other: enforcement of non-compete restrictions. And in this instance, the Administration would seek to reduce the options available to American businesses, rather than expand them.

Vice President Biden made a Facebook post yesterday in which he attacked the manner in which non-compete restrictions are used:

> ***In some cases, companies may be legitimately trying to use non-competes to protect their trade secrets. But often, these agreements can create unnecessary roadblocks for any worker trying to get a raise, looking to move up the ladder by joining another employer, or even start their own company. Workers are regularly surprised that they have to sign a non-compete when they take a job, and are often led to believe the agreements are enforceable -- even though many non-compete agreements are not. What's worse, these agreements can even apply when a worker is laid off. Use of non-competes is widespread -- almost one fifth of all workers are subject to them, including a shocking 14 percent of low-wage workers. The person making your sandwich, packing your online shopping order, or pet-sitting your dog could be banned from seeking a different job in their industry. That's power for companies, but less choice for workers.***

Biden does not argue in favor of an outright prohibition of non-compete restrictions. Also, it is unclear whether he is also referring to lesser restrictive covenants (provisions concerning customer non-solicitation, employee non-solicitation, and use or disclosure of confidential information) under the pejorative term "non-competes." Nevertheless, he is identifying a number of ways that non-compete restrictions are attacked at the margins:

Surprise at being made to sign a non-compete - Employees who attack the enforceability of restrictive covenants (especially in states with pro-enforcement legal regimes) often point to the circumstances under which they signed the agreements, something to the effect of "I quit my job and then when I had no other options, my new employer made me sign a non-compete agreement on my first day of employment." Depending on the judge, these arguments can be effective, especially

my first day of employment." Depending on the judge, these arguments can be effective, especially in a injunctive relief situation where the balance of the equities matter. Certain states such as Oregon have written notice requirements into their restrictive covenant statutes.

Being led to believe that agreements are enforceable - this hits on a pair of arguments that employees make to invalidate non-compete restrictions. One is that they were not given time to consider the agreements so that they could have a lawyer review them. In practice, most employees will not go to the trouble to pay a lawyer to review a restrictive covenant agreement, but that might be changing as non-compete restrictions increase in frequency and profile. A second is that they allege that they were misled as to the contents of the agreement. While this typically does not have legal effect as to an integrated agreement, it can have a personal effect on a judge.

Application of restrictions to employees who are laid off - this hits on an argument that has strong force in jurisdictions like New York, where it can be very difficult for an employer to enforce a restrictive covenant against an employee whom it terminated. A lay-off is a more limited concept than a termination, so it could be that Biden is simply talking about employees who are let go as a result of business conditions and as part of a group. It could also be that he means the broader concept as exists in New York, which can create all sorts of difficult situations where an employy can engage in transgressive behavior in an attempt to get fired and therefore be released from a non-compete restriction. It can also lead to fact-intensive disputes regarding whether an employee was truly discharged voluntarily by the employer and/or engaged in strategic behavior.

Lower-wage employees signing restrictive covenants - this is a frequent criticism of restrictive covenant agreements, most prominently raised in the media attention to Amazon having hourly workers execute non-compete restrictions. Most recent restrictive covenant statutes have addressed this concern. For instance, Georgia's restrictive covenant statute, which passed in 2009 and went into effect in 2011, limits the categories of employees who can be subject to non-compete restrictions (as opposed to other restrictive covenants). As a practical matter, it is extremely difficult to convince most courts to enforce restrictive covenants against lower-level employees and while there is ample media attention covering employers that have low-level employees sign restrictive covenant agreements, there is very little evidence of employers actually taking steps to enforce such agreements. However, the argument that Biden and other make is that the mere specter of the agreements can reduce worker mobility and depress wages, even if the agreements are nothing more than a bluff.

An interesting overlay to the discussion is that restrictive covenant law is an exclusive province of state law. The federal court decisions on restrictive covenant law exclusively interpret state substantive law. Indeed, one of the interesting and challenging aspects of restrictive covenant law is the vast difference between states in terms of enforcement, from California, which prohibits non-compete restrictions in the employment context and considers the use of such agreements to be an unfair business practice, to Florida, whose statute requires judges to modify otherwise unenforceable restrictive covenants. Biden acknowledges that non-compete legal changes would need to come out of the states in his Facebook post:

Today, the White House is releasing a report about these sorts of agreements: what states are already doing to protect workers, and new proposals for further action. It will lay the groundwork for more conversations with experts and practitioners. And in the next few months, we'll start by putting forward a specific set of best practices for state reforms.

Indeed, the White House report referenced in Biden's post acknowledges that state legislatures will need to take up the issues raised in the report. In the end, the likely result would be that Democratic state legislatures that are inclined to follow the Obama White House's lead on policy would address the issues raised in the Report and Republican legislatures would not. Between the NLRB's efforts to punish companies from using broad non-disclosure provisions and this latest push for state reform of "non-compete" law, it appears that the Obama Administration is spending some of its final months on the subject of limiting the use of restrictive covenants.

White House Non-Compete Report.pdf (455.28 kb)

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