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How Does the Latest Crackdown on Noncompete Agreements Affect US Employers?

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Noncompete agreements have come increasingly under attack at the federal and state level in 2023. In this alert, we review notable recent developments on the legality of continuing to use noncompete agreements in the employment context. Companies utilizing noncompete agreements in the US should confer with legal counsel to ensure that their practices remain in compliance with applicable law.

California

1. Senate Bill 699

In September 2023, California Gov. Gavin Newsom signed SB 699, which broadly expands the state's already existing strong public policy against noncompetes, reflected in Business and Professions Code Section 16600 (providing that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void"). Limited exceptions under the code permit noncompete agreements in the context of the sale of a business, dissolution of a partnership, or dissolution of, or termination of an interest in, a limited liability company.

SB 699, which is effective January 1, 2024, adds Section 16600.5 to the code and clarifies that existing law prohibits noncompetition covenants **regardless of where or when the agreement was signed, even if the covenant was signed outside of the state.** An employer commits a civil violation for entering into or attempting to enforce a void noncompete. Former and prospective employees now also have a private cause of action against any employer, and in addition to injunctive relief and actual damages, may recover attorneys' fees and costs, if successful.

In drafting the new law, the Legislature noted that, as remote work has grown, employers outside of California have increasingly attempted to prevent the hiring of their former employees within California through the use of noncompete agreements. Although California law has long prohibited noncompetes, out-of-state employers have sought to skirt that prohibition by asking non-California employees to sign noncompetes governed by the law of a different state, then seeking to enforce those agreements against former employees who subsequently start working for a competitor in California. Thus, the law highlights the state's interest in protecting the "freedom of movement of persons whom California-based employers wish to employ to provide services in California, regardless of the person's state of residence," which the state deems "paramount to competitive business interests."

Under this expansion, employers outside California would violate Section 16600.5 not only if they required a worker performing services in California to sign a noncompete, but also if a non-California employee who signed a noncompete moves to the state and begins working in California for the same employer or for a different employer – even if the noncompete was fully valid under the law of the state where the employee originally resided and worked.

The law spurs many questions that will need to be tested through the court system. For example, it is unclear how SB 699 will interact with California Labor Code Section 925, which prohibits employers from requiring employees who primarily reside and work in California to agree to adjudicate claims outside of the state or deprive the employee of the substantive protection of California law, unless the employee was represented by legal counsel. It is also unclear what effect a judgment secured outside of California enforcing a noncompete would have within the state. SB 699 raises constitutional issues as well, including whether the law poses an undue burden on interstate commerce or impairs the obligation of contracts entered outside the state.

2. Assembly Bill 1076

Not to be outdone by SB 699, AB 1076 is the second significant noncompete bill to come out of this California legislative session and was signed by Newsom on October 13, 2023. This bill amends Section 16600 of the

state's Business and Professions Code to codify the California Supreme Court's holding in *Edwards v. Arthur Andersen LLP,* 44 Cal. 4th 939 (2008), and "void the application of any noncompete agreement in an employment context, or any noncompete clause in an employment contract, no matter how narrowly tailored." The law provides that Section 16600 should be "read broadly," and it requires employers to notify any current or former employees who were employed after January 1, 2022, and have contracts containing a noncompete clause covered by Section 16600, that such noncompete clause is void. The notice, which must be completed by February 14, 2024, must be written and delivered to the last known address and email address of the employee. Failing to provide such notice constitutes a violation of the state's Unfair Competition Law, which carries civil penalties.

This law also spurs many questions that will need to be tested through the court system, likely alongside SB 699. For example, read literally, AB 1076 covers all employees everywhere, including where a noncompetition covenant is presently enforceable but theoretically could become unenforceable under SB 699 if an employee relocates to California.

Other pending legislation and agency enforcement

FTC's proposed rule

As we reported in a previous client alert, in January 2023, the Federal Trade Commission (FTC) published a proposed rule that would not only categorically ban noncompete agreements between employers and a broad class of workers, but also would require employers to rescind existing noncompete agreements and – like California's AB 1076 – notify current and former employees that those noncompete clauses are no longer in effect. This sweeping proposed rule had received nearly 27,000 comments as of May 2023, and is expected to be voted on in April 2024.

Proposed federal legislation

Shortly after the publication of the FTC's proposed rule, on February 1, 2023, the Workforce Mobility Act of 2023 was introduced in the House. Like the FTC rule, this proposed legislation would ban all noncompete agreements subject to limited exceptions. To date, no further action has been taken on the bill.

New York's Senate Bill S3100A

In June 2023, New York passed its own proposed noncompete ban, which is on its way to the Gov. Kathy Hochul's desk for her signature. If the law is signed, New York would be the fifth state in the country (following, most recently, Minnesota) to ban noncompete agreements.

S3100A would add a new Section 191-d to the state's labor law to prohibit employers from seeking or requiring entering into a noncompete agreement with anyone who is in a "position of economic dependence on, and under an obligation to perform duties for, that other person." Though unclear, this broad definition could be interpreted to include not just employees but also independent contractors. The bill broadly defines a noncompete agreement as "any agreement, or clause contained in any agreement, between an employer and a covered individual that prohibits or restricts such covered individual from obtaining employment, after the conclusion of employment with the employer included as a party to the agreement." If signed, the law will be effective 30 days later and will affect agreements entered into on or after that date. Certain agreements are exempted from this prohibition, provided that they do not otherwise restrict competition, including agreements that:

- Are for a "fixed term of service" with any covered individual.
- Protect trade secrets and confidential and proprietary client information.
- Prohibit solicitation of clients of the employer that the covered individual learned about during employment.

The law also provides for a private right of action against any employer who violates the law. An employee must bring the action within two years of the later of:

- When the noncompete agreement was signed.
- When the individual learns of the prohibited noncompete agreement.
- When the employment relationship is terminated.
- When the employer takes steps to enforce the noncompete agreement.

The court is empowered to order all relief, including an injunction, liquidated damages, lost compensation,

damages, and reasonable attorneys' fees and costs.

The bill leaves many questions unanswered. For example, unlike the proposed FTC rule, S3100A does not directly address the permissibility of noncompetition agreements in the context of a sale of a business, or whether employers can continue to use garden leave and notice periods, or forfeiture for competition provisions. Further, while the bill carves out certain exceptions, it does not address the permissibility of other kinds of nonsolicitation agreements, such as employee nonsolicitation clauses.

National Labor Relations Board (NLRB)

1. General counsel's memo

Following in the FTC's footsteps, on May 30, 2023, NLRB General Counsel Jennifer A. Abruzzo issued a memo asserting that the "proffer, maintenance, and enforcement" of noncompete provisions in employment contracts violate the National Labor Relations Act (NLRA) Section 7, which guarantees employees the right to bargain collectively and engage in concerted activities, and Section 8(a)(1), which prohibits employers from interfering with, restraining, or coercing employees in the exercise of their Section 7 rights. In the memo, Abruzzo asserts that noncompetes chill employees from engaging in several types of protected Section 7 activity, including making a concerted threat to resign to demand better working conditions, and in soliciting co-workers to go to work for a local competitor as part of a broader course of protected concerted activity.

Abruzzo also noted that noncompetes must be narrowly tailored to special circumstances justifying the infringement on employee rights. Although she did not provide any examples of such "special circumstances," protecting legitimate business interests in proprietary/trade secret information must be addressed with "narrowly tailored workplace agreements," and a mere desire to avoid noncompetition from former employees or to protect special investments in training employees is not sufficient. Notably, Abruzzo stated that noncompetes may not be justified when they are imposed on low- or middle-wage workers.

Abruzzo ended the memo by encouraging all NLRB regions to seek make-whole relief for employees who can demonstrate they lost opportunities for other employment because of an overbroad noncompete, such as "evidence of any adverse consequences, including specific employment opportunities employees lost because of the agreements."

While the memo does not have the force of law, it highlights the agency's enforcement priorities, and previews the types of arguments the NLRB may make in cases involving restrictive covenants. Indeed, as highlighted in the Juvly lawsuit below, Abruzzo's memo is already being used as a blueprint for the agency's enforcement efforts. As a reminder, Abruzzo's position does not apply to agreements with supervisors and managerial employees, or independent contractors, who are specifically excluded under the NLRA.

2. Lawsuit against Harper Holdings (d/b/a Juvly Aesthetics)

As foreshadowed by the memo, on September 1, 2023, the regional director of the NLRB in Cincinnati, Ohio, issued a consolidated complaint against Harper Holdings, LCC d/b/a Juvly Aesthetics, alleging that Juvly maintained a series of unlawful policies and provisions, including noncompetes.

The NLRB took issue with the following policies as violative of the NLRA:

- A **two-year noncompete** for certain employees that restricted employees from practicing aesthetic medicine or having an ownership interest in, investing in, or providing services at any other medical practice within a 20-mile radius.
- A **two-year nonsolicitation clause** prohibiting all employees from directly or indirectly soliciting or encouraging any person to leave employment, hiring any current or former employee, intentionally interfering with any relationship of the company or its affiliates or its employees, or enticing away from the company any contractor, adviser, employee, or another client of the company or its affiliates. (The policy even prohibited departing employees from notifying clients of their departure or employment status, and former employees were required to pay $150,000 for every employee solicited away and $25,000 for every client solicited away, with interest for payments past due.)
- A **training repayment policy** directing repayment of up to $105,000 for the cost of training and continuing education provided during employment, if the employee left within two years of being hired.
- A **confidentiality policy** that prohibited employees from discussing salaries, bonuses and compensation packages, as well as "employee-related information," to anyone outside the company and to each other.

- An **insubordination policy** that prohibited workplace "drama" and provided that "[t]hreats, disparagement, or intimidation of management or other employees or malicious or disparaging statements concerning individuals within management, other employees, or [t]he [c]ompany" constituted insubordination.
- A **nondisparagement policy** prohibiting employees from making "negative comments" about the company during and after employment.

The NLRB seeks "all just and proper relief," including rescission of the unlawful policies, training costs and make-whole monetary relief for the former employees. The case is scheduled for a hearing on November 28, 2023.

What now?

Employers using noncompete agreements should think about taking the immediate steps outlined below.

1. Get back to basics.

Employers using noncompete agreements should re-evaluate and identify their goals for utilizing such agreements as a policy matter. In this exercise, employers should identify the protectable interests justifying the need for the noncompete, whether it is trade secrets, confidential or sensitive information, intellectual property, customer or client lists, goodwill, or investments in employee training. These categories of interests (and the positions most likely to involve access to them) need to be carefully articulated and defensible from a business perspective if the clause is challenged in court. For example, the legitimate business interests applicable for a salesperson, which may include protecting existing relationships with customers or clients, may be different for an employee in a more technical role, which may include protecting confidential information and trade secrets. Employers should ensure that the scope of a noncompete agreement's restricted activities are actually necessary to protect those business interests.

2. Review and revise existing agreements.

Employers should carefully review and revise existing agreements for continuing developments, including those identified above. Employers with California employees should carefully review their employment agreements for compliance with SB 699 and AB 1076 and issue compliant agreements moving forward. Employers also should note that AB 1076 is retroactive – it affects existing agreements, as well as agreements imposed on former employees employed after January 1, 2022. In addition, employers should consider the relevant pool of current and former employees to receive notice under AB 1076, while ensuring that the notice includes language that makes clear the company will not attempt to enforce the noncompete clause. Employers should immediately evaluate and create processes to handle the administrative and logistical challenges of providing notice to affected employees. This process should include consideration of how voiding existing noncompetes, and/or not requiring noncompetes for some but not all employees moving forward, will impact employee morale in the workplace. In some cases, employers with businesses relying on trade secrets should consider whether to continue doing business in California, including hiring employees in the state.

Where noncompetes are legal, employers may want to consider whether adjustments need to be made to such agreements, including limiting the duration, the range of employees required to sign a noncompete (such as excluding more junior employees or the low-wage workers identified by Abruzzo), and more carefully tailoring the scope of prohibited activity. Employers should analyze whether individualized agreements may make sense for higher-level employees as well. Employers can enhance the enforceability of their agreements by narrowly tailoring the noncompete.

3. Adequately protect trade secret information.

Regardless of whether the pending legislation described above becomes law, trade secrets protection laws will continue to exist to protect legitimate trade secrets. These laws include the federal Defend Trade Secrets Act and similar state laws prohibiting the misappropriation of trade secrets. These laws can provide additional remedies including injunctive relief to prevent actual or threatened misappropriation, damages, and attorney's fees, in some cases. In seeking protection under these laws, however, employers should note that they must have taken reasonable steps to keep such trade secret information secret. These steps can include implementing comprehensive protective measures, such as:

- Proper policies, procedures, and training for employees on protecting and handling trade secrets (including adequate descriptions of company trade secrets).
- Limiting access to such trade secrets to those with a legitimate need to know the information.

- Protecting access to trade secret information by adequate security measures (i.e., password protection and encryption).
- Processes to terminate access in the event an employee separates employment.
- Adequately marking documents as confidential or as containing trade secrets.

4. Consider alternative restrictions.
Fortunately, much of the recent focus has been on noncompete covenants, which can be perceived as restricting a worker's job mobility. As the FTC noted in its proposed rule, other restrictive covenants such as nondisclosure agreements and client or customer nonsolicitation agreements are not included in its definition of a prohibited noncompete because they "generally do not prevent a worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer." Employers should thus consider utilizing less burdensome restrictions that remain legal and effective in protecting business interests. Employers should reasonably tailor such clauses, however, to avoid them being construed as "de facto" noncompetes.

Employers with questions about the use of restrictive covenants, including compliance with the new California laws, should contact their Cooley employment lawyer.

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