The Future of Non-Compete Agreements

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On July 9, 2021, President Biden issued an "Executive Order on Promoting Competition in the American Economy." Notably, the order encourages the FTC to promulgate rules to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."[1] Earlier that day, the White House issued a Fact Sheet explaining that the order is intended to promote economic competition, and "[e]ncourages the FTC to ban or limit non-compete agreements."[2] The White House identified the ubiquity of non-compete clauses in private employment contracts—particularly in the construction and retail industries—as a costly impediment to competition. Analysts have focused on two ambiguities in the documents: (1) the Executive Order's focus on "unfair" non-compete agreements; and (2) the extent to which the FTC will "curtail," "limit," or "ban" the practice. These ambiguities, and the inevitable challenge to any forthcoming FTC rules confuse the future enforceability of non-compete clauses in employment contracts.

The enforceability of non-competes is determined by state law, and different approaches among the states may help clarify what is to come. Non-competes are generally enforceable if they (1) protect the legitimate business interests of the employer (such as guarding its trade secrets and other proprietary information); (2) are reasonably tailored in scope, geography, and duration; and (3) do not impose an undue burden on the employee or offend public policies. Many states maintain statutes governing non-compete clauses. The most restrictive are California, North Dakota, and Oklahoma, which ban non-compete clauses outside of narrow statutory exceptions. Washington D.C. has passed the Ban on Non-Compete Agreements Amendment Act, which if implemented, will completely ban non-competes in the capital. Other states impose less restrictive conditions on non-competes. For example, Illinois, Maryland, New Hampshire, Oregon, Rhode Island, Virginia, and Washington prohibit non-compete clauses where workers earn below a statutory threshold. Some others—like Colorado, Georgia and Oregon—require that the employee performs managerial functions, like hiring and firing. Finally, states like Texas do not statutorily impose greater restrictions on non-competes and generally find them enforceable.

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[1] https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/

[2] https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy/

Given the differential treatment of non-competes across jurisdictions, and the pending FTC rulemaking, employers would be well-advised to evaluate their employment practices with regard to non-compete clauses. It seems likely that the FTC will take a conservative approach, seeking to limit enforceable non-competes only to highly compensated, managerial and executive employees. The Executive Order's reference to the "unfair" usage of non-competes supports this conclusion, suggesting that there are contexts where such agreements remain fair. So does the Fact Sheet's mention of the construction and retail industries, since those workers do not typically possess valuable trade secrets, client lists, or other employer interests protected by non-competes. Whether the FTC will impose an earnings threshold, a managerial worker requirement, some other condition, or a combination thereof remains to be seen.

One lesson that can be taken away from these developments so far is that, going forward, employers who take a one-size-fits-all approach to non-competes could face significant challenges to their enforceability. An employer who obligates employees to a non-compete regardless of their role or seniority may suffer the unintended consequence that even non-competes as applied to more senior level employees face challenges to enforceability, since the employer did not carefully calibrate the non-compete to address its legitimate business interests as specifically related to such employees.

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