State Notes

TOPICS OF LEGISLATIVE INTEREST

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Locked In or Locked Out? An Overview of Noncompete Agreements and Their Regulation
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Executive Summary

- Noncompete agreements are restrictive agreements that historically have been disfavored but tolerated in most of the 50 states.
- The enforceability of noncompete agreements typically is governed by state law but is subject to Federal antitrust law.
- Some research demonstrates that noncompete agreements are effective at protecting trade secrets, sensitive information, and investments in worker training, but have tradeoff costs in the form of reduced worker wages and business formation.
- The current trends with respect to enforcement of noncompete agreements demonstrate increased skepticism of (if not hostility to) these agreements, particularly at the Federal level.

INTRODUCTION

The nature of business enterprise often requires businesses to place their employees, independent contractors, or other parties in a position to learn specialized or confidential information or trade secrets that belong to that enterprise. In an open economy, this information sharing entails certain risks, as employees or business partners can move to or form another business, taking that information with them. One of the most common means to address these risks is the noncompete agreement. While the status of noncompete agreements has varied over time, they have historically been disfavored. Their use has been tolerated in recent history; however, within the last 10 years, these agreements have come under renewed scrutiny by state and Federal governments (perhaps largely because of high-profile uses of noncompete agreements for low-wage employees). This paper provides an overview of noncompete agreements and the pertinent law, as well as state and Federal trends governing the use of noncompete agreements.

This paper first examines noncompete agreements generally, provides a general overview of the law governing noncompete agreements (focusing on the legal landscape of noncompete agreements in Michigan), and describes alternative mechanisms for protecting competitive interests. Next, the paper discusses the uses of noncompete agreements and identifies common arguments supporting and criticizing their use. Lastly, the paper summarizes various actions taken by state legislatures, enforcement bodies, and the Federal government to limit or ban the use of noncompete agreements. While noncompete agreements can be executed between any type of party (i.e., between two businesses, between a business and an individual, etc.), the paper's primary focus will be those agreements executed between employers and workers (broadly construed).

GENERAL INFORMATION AND LAW ON NONCOMPETE AGREEMENTS

Noncompete Agreements, Generally

A noncompete agreement (also known as a covenant not to compete, a noncompetition agreement, or a noncompete clause) is an agreement in which one party agrees not to work

for (or go into business as) a competitor for some period. These agreements typically arise in employment contracts or agreements for the sale/purchase of a business. The provisions that comprise an agreement may include restrictions as to the types of business that a party may or may not engage in, the duration of the agreement, and the geographic area in which the agreement applies (e.g., a certain region or a specified radius from the other party's business). In most (if not all) states that allow them, the agreements must be narrowly tailored to those parameters. The rationale for executing these agreements is premised on the prospect that an employee or business partner might, after termination of the employer-employee or business relationship, use confidential or trade secret information, specialized training, or specialized information to gain a competitive advantage in the business landscape.

If one of the parties to an agreement violates it, often the first step taken is the issuance of a cease-and-desist letter. However, the aggrieved party may sue that party for breach of contract. The suing party's immediate remedy often is a preliminary injunction that orders the violating party to stop the conduct alleged to violate the agreement while litigation is ongoing. If the suing party prevails, the court may issue a permanent injunction requiring the losing party to cease the conduct that violates the agreement. A court also may order the payment of monetary damages (e.g., actual or liquidated damages).

In addition to noncompete agreements, Federal regulators note that other agreements can be so broad as to become de facto noncompete agreements. These include the following:

- Training-repayment agreement: a worker agrees to pay the employer for its training expenses if the worker leaves the job before a specified date.
- Nondisclosure agreement: prohibits a party from disclosing specified information, usually for a set period of time.
- Nonsolicitation agreement: prohibits a party from soliciting a business's former customers or clients.
- No-recruit/no-poach agreement: prohibits a party from recruiting or hiring a business's workers.

The Law Governing Noncompete Agreements

For all intents and purposes, noncompete agreements always have been disfavored under British law, and later, United States law. Under early English common law, these agreements were outright unenforceable on public policy grounds as undue restraints of trade.[1] This principle remained the law in England until the modern framework for evaluating restraints of trade limited to time, person, and place was articulated in the 1711 case of *Mitchel v. Reynolds*.[2] Since the United States borrowed much of its early law from English common law, the US inherited these principles, too. In keeping with the concept of the 50 states as "laboratories of democracy", each state has dealt with the question of noncompete agreements in its own way. Thus, the question of whether a court will enforce a noncompete agreement (for the time being) depends predominately on the applicable state's laws. At present, 46 states (including Michigan) allow courts to enforce noncompete agreements in the context of an employer-worker relationship under some circumstances.

Until the 1980s, Michigan's antitrust laws generally prohibited contracts in restraint of trade, including noncompete agreements. This changed in 1987 with the amendment of the Michigan Antitrust Reform Act (MARA) (which had been enacted three years earlier) to identify circumstances under which noncompete agreements are permissible. While still prohibiting unreasonable restraints of trade, MARA allows an employer to obtain from an *employee* an agreement that protects an *employer's* reasonable competitive business interests (e.g.,

goodwill, trade secrets, confidential information) and prohibits an employee from engaging in employment or a line of business after termination of employment if the agreement is reasonable as to its duration, geographical area, and the type of employment or line of business.[3] Moreover, the statute allows a court that finds an agreement unreasonable to make it reasonable (or "blue line" it) in light of the circumstances. This statute applies only in the context of employer-employee noncompete agreements.[4]

With respect to noncompete agreements between business entities and those between businesses and independent contractors, Michigan courts rely on Section 2 of MARA (i.e., "[a] contract, combination, or conspiracy between [two] or more persons in restraint of, or to monopolize, trade or commerce in a relevant market is unlawful") as well as the so-called "rule of reason", which is derived from caselaw on Federal antitrust law.[5] As articulated by the Michigan Supreme Court, the rule of reason requires a court to "'tak[e] into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint's history, nature, and effect.'"[6]

As with nearly all states that enforce noncompete agreements, whether an agreement protects a reasonable competitive business interest and is reasonable as to duration, geographical area, or type of employment or line of business are intensively fact-based inquiries. Because noncompete agreements are contracts (or provisions of contracts), they also are governed by the general law of contracts. Michigan courts also may look to circumstances outside of the "four corners" of the agreement. For example, when deciding whether and to what extent to enforce a noncompete agreement, Michigan courts have considered the circumstances surrounding the employee's termination and the ability of the employee to earn income.[7]

While most of the law governing noncompete agreements originates from the states, some applicable Federal laws affect these agreements. Section 1 of the Sherman Antitrust Act specifies that "[e]very contract…in restraint of trade or commerce among the several States…is declared to be illegal."[8] Noncompete agreements *are* contracts in restraint of trade. A person who violates Section 1 of the Sherman Antitrust Act is guilty of a felony and may be punished by fines of up to $100.0 million (if a corporation) or up to $1.0 million (if any other entity) or by up to 10 years' imprisonment.[9] In addition, Section 2 of the Sherman Antitrust Act prohibits monopolization. However, despite these provisions, plaintiffs (governments and private parties) have had limited success using the Sherman Antitrust Act to render noncompete agreements unenforceable.[10] As discussed in greater detail below, the Federal government also has turned to the Federal Trade Commission Act to curtail the use of noncompete agreements.

Alternatives to Noncompete Agreements

Because of their disfavored status, and recent efforts made to restrict or eliminate the use of noncompete agreements, businesses that employ them often resort to other means (as alternatives, or in tandem with noncompete agreements) to protect their legitimate business interests and sensitive information. These means often relate to disparate statutory provisions governing business activity and present their own advantages and disadvantages.

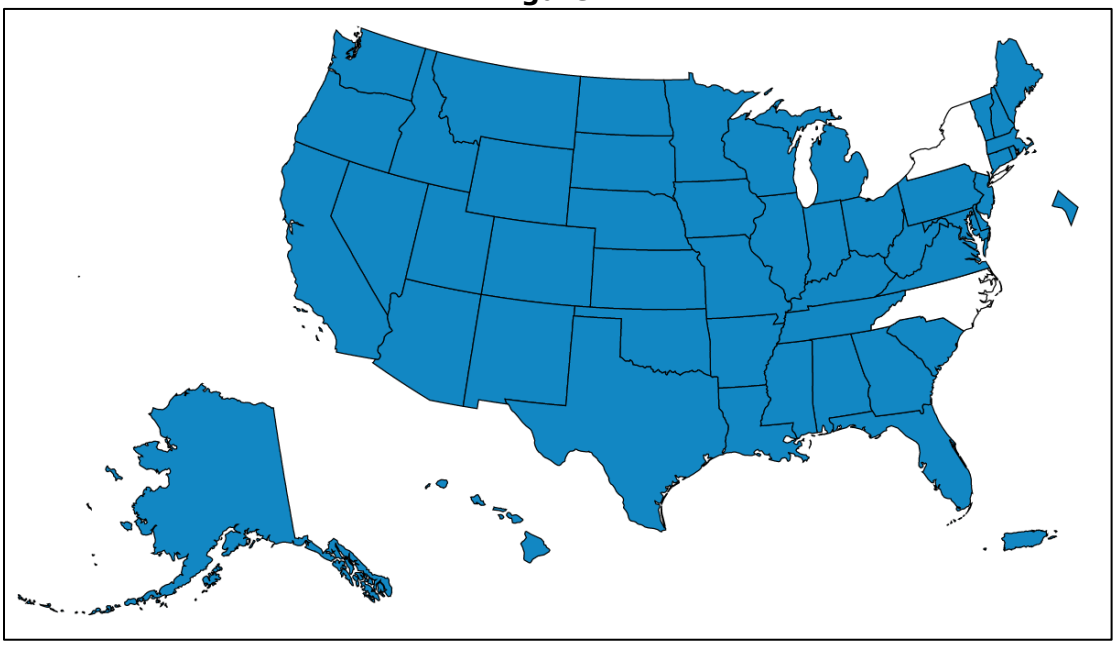
State and Federal law allows several avenues to protect intellectual property from infringement or misappropriation. The law of patents (for novel products or processes, i.e., inventions), trademarks/service marks (for logos and brands), and copyrights (for original artistic or literary works) is well-developed. The law of trade secrets, which is even more germane to the types of information that noncompete agreements seek to protect, also is

well-developed under state and Federal law. As of April 2023, 48 states (including Michigan) have enacted some version of the Uniform Trade Secrets Act (see Figure 1). These Acts generally define "trade secrets" as

> information, including a formula, pattern, compilation, program, device, method, technique, or process, that derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[11]

As applied by various courts, this definition allows practically any information to be considered a trade secret under the right circumstances.[12]

Figure 1



Source: Uniform Law Commission. Adopting states in blue. Retrieved April 28, 2023.

The Uniform Trade Secrets Act, with some variations across states, allows a party to enjoin actual or threatened misappropriation of a trade secret and to collect damages (actual damages or in the form of a reasonable royalty) if a trade secret is misappropriated. Misappropriation is defined as either of the following:

> (i) Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means.
> (ii) Disclosure or use of a trade secret of another without express or implied consent by a person who did 1 or more of the following:
> (A) Used improper means to acquire knowledge of the trade secret.
> (B) At the time of disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was derived from or through a person who had utilized improper means to acquire it, acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use, or derived from or through a person who owed a duty to the person to maintain its secrecy or limit its use.

(C) Before a material change of his or her position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.[13]

Trade secrets also are protected at the Federal level. Congress enacted the Defend Trade Secrets Act in 2016, which allows parties to bring a civil claim under Federal law for the misappropriation of trade secrets, and for courts to award damages for the misappropriation. Under extraordinary circumstances, a court may order the seizure of property to prevent the dissemination of the trade secret information or material. Under the Economic Espionage Act, the theft of a trade secret for the benefit of a foreign entity or the economic benefit of anyone other than the owner is a Federal crime.

Businesses interested in protecting sensitive information can avail themselves of other contractual protections, including nondisclosure agreements (also called confidentiality agreements). Nondisclosure agreements are subject to a state's laws on contracts (including for breaches of those agreements) and cover only the information that the contract designates as confidential. In addition, nondisclosure agreements are, as a rule, more enforceable than noncompete agreements. Under Michigan case law, a nondisclosure agreement must be reasonable to be enforced.[14]

Other alternatives to noncompete agreements are available at the individual party level. Specifically, employers could directly compete for workers with increased compensation, better working conditions, or better benefits (or some combination of these) to keep their employees from seeking opportunities elsewhere. Another alternative is to enter into employment contracts with employees with whom sensitive information is shared or specialized training is needed. These agreements could be of a fixed duration that would be sufficient to compensate the firm for its expenditures in specialized training or for providing specialized knowledge.

There are disadvantages to all of the above approaches. Trade secret litigation is substantially more expensive, time-consuming, and unpredictable than litigation related to noncompete agreements. Detecting the misappropriation of a trade secret, or the improper disclosure of confidential information, can be difficult. An employee who resigns from a firm and takes a job with a competitor may be able to provide an unfair competitive advantage without outright breaching a nondisclosure agreement or misappropriating a trade secret. Other methods of protecting unfair competition, particularly employment contracts and increased benefits or compensation, generate higher labor costs, increased attorney fees (to negotiated and draft employment contracts for employees with various goals and training costs), and the possibility of increased litigation or settlement costs if employees or employers terminate or breach these agreements.

Uses for, Benefits of, and Criticisms of Noncompete Agreements

Research on the effects of noncompete agreements on various aspects of markets and the economy (e.g., worker training and wages, market concentration, innovation, business formation, consumer welfare and prices, etc.) is a relatively new phenomenon. In many cases, the research is inconclusive because of confounding factors, the dynamic nature of markets, and the difficulty in isolating the effects of noncompete agreements on the studied parameter from other factors. The arguments for and against noncompete agreements are extensive, and an in-depth recitation of them is beyond the scope of this paper. In addition, whether one supports or opposes the use of noncompete agreements typically reflects one's normative views about labor, business, and the economy. The reader should keep these facts in mind

when examining arguments for or against noncompete agreements and the research that supports them. Although an in-depth discussion of the research on noncompete agreements is beyond the scope of this paper, this paper will briefly summarize some of the research on a given facet of noncompete agreements where pertinent. These summaries are presented to provide greater context to the discussion, not to persuade the reader that the enforcement of noncompete agreements is a net benefit or cost to society.

As noted above, noncompete agreements typically are applied to employer-worker relationships. However, noncompete agreements also are used in the sale of businesses or portions of businesses, or in arrangements between businesses not to perform work for a competitor. In all of these contexts, noncompete agreements can provide a business with benefits that may positively affect its operations. Primarily, these agreements allow businesses to safeguard their trade secrets, confidential information, and other sensitive information from being shared with competitors.

Although various alternatives to noncompete agreements may protect trade secrets or confidential information, these options pose separate challenges and may not be as protective as noncompete agreements. Opponents counter that California, for example, has a longstanding (since 1872) ban on the enforcement of noncompete agreements and yet hosts the headquarters of some of the largest companies in the world, including many technology companies that rely on trade secrets and sensitive information to maintain their competitive advantage. North Dakota and Oklahoma have strong oil and gas industries that rely on trade secrets and sensitive information, and they, too, ban noncompete agreements. However, these examples fail to indicate whether these successes occur despite these states' laws on noncompete agreements (because of weather or the location of resources) or whether the laws play a role in those states' successes.

Proponents of noncompete agreements also contend that these agreements encourage investments in employee training, professional development, and associated capital improvements, by allowing a business to protect those investments. Some evidence supports this claim. One recent study states that "[a]n increase from no enforcement of noncompete agreements to mean enforceability is associated with a 14% increase in training…."[15] Other papers make similar claims with respect to training and capital improvement.[16]

Governments have long recognized the primary issues inherent in noncompete agreements as those of restraint of trade and restricted competition for labor. Opponents of noncompete agreements claim that noncompete agreements impair labor markets, which has the effect of weakening business formation and reducing earnings for workers in the aggregate.

Effective labor markets function by matching employers and employees easily. In theory, a worker seeking a job that better matches his or her objectives can enter that market to look for work. An employer competes with other employers for that employee. On the other hand, an employer seeking an employee who best matches its objectives also can enter that market. The prospective employees applying for that job compete for that position. Having more options for each employer and employee to match jobs with skills improves the quality of the matches between employers and employees. Again, in theory, this greater competition should result in higher worker earnings, increased productivity, and greater economic output.

Noncompete agreements, critics note, impair labor markets by restricting a worker's ability to change jobs. Likewise, by restricting a worker's ability to change jobs, other businesses' ability to hire that worker also is restricted. Critics argue these chilling effects occur even in states or in situations (such as the often-cited example of Jimmy John's use of noncompete

agreements for low-wage employees) where noncompete agreements are unenforceable.[17] While the effect on any one employer or employee may be marginal to the economy as whole, many surveys of employees suggest that anywhere from 14%-20% (and perhaps higher) of the United States workforce may be subject to a noncompete agreement.[18] Critics note that, with rates that high, the aggregate effect on the economy is substantial. Critics assert fettered labor markets reduce business formation, because those who are subject to noncompete agreements are prevented from forming new businesses in the same or similar fields.[19]

Opponents of noncompete agreements also note that in geographic areas where noncompete agreements are enforced, workers earn less. This reduction applies to those who are subject to noncompete agreements and to those who are not. Several studies support these conclusions.[20] Furthermore, if enforcement of noncompete agreements were curtailed, opponents and scholars suggest that worker earnings could increase by 3% to 13% (with most studies suggesting an increase in the 3%-4% range).[21] Supporters of noncompete agreements have criticized the methodology of these studies.[22] Moreover, these supporters contend noncompete agreements allow companies to justify hiring less experienced workers (who are paid less) and to provide those workers better training.[23]

STATE ACTION RELATED TO NONCOMPETE AGREEMENTS

As noted above, 46 states allow for enforcement of noncompete agreements under some circumstances. Three of the remaining states, California, North Dakota, and Oklahoma, have longstanding statutory provisions that prohibit the enforcement of nearly all employer-worker noncompete agreements.[24] These three states have limited exceptions for the sale of businesses or goodwill. Oklahoma also allows the use of nonsolicitation agreements and agreements not to poach another's employees or independent contractors. As of May 24, 2023, Minnesota joined these states in adopting a ban on most noncompete agreements.[25]

Over the last 10 years, legislative and enforcement activity to restrict or invalidate noncompete agreements has increased. According to Beck Reed Riden LLP, in 2022, there were 98 bills related to noncompete agreements proposed in 29 states and the District of Columbia.[26] As of March 20, 2023, 65 bills had been introduced in 2023.[27] What follows is a brief overview of some of the proposed and enacted restrictions (most of which within the past 10 years). Note that some states have proposed or adopted various combinations of these.

Limitation by Income

Some states prescribe or have proposed limitations on the enforcement of noncompete agreements if an employee earns at or below a certain income threshold. As of July 1, 2020, Virginia prohibits employers from entering into noncompete agreements with "low-wage employees", i.e., those whose average weekly earnings are less than the average weekly wage of Virginia (which is determined on an annual basis).[28] "Low-wage employee" includes interns, students, apprentices, or trainees employed, with or without pay, at a trade or occupation to gain work or educational experience, as well as independent contractors who are compensated for services at an hourly rate that is less than the median hourly wage for Virginia.

The Michigan Legislature has proposed similar restrictions in nearly every session since the 2015-2016 legislative session.[29] The most recent iterations of these, Senate Bill 143 and House Bill 4399 of the 2023-24 legislative session, would prohibit an employer from obtaining a noncompete agreement from an employee or applicant for employment who is, or would be

hired as, a low-wage employee. Under Senate Bill 143, "low-wage employee" would mean an employee who receives compensation from the employer, excluding overtime compensation, at a rate less than the greater of any of the following: a) $15 per hour; b) 150% of the State minimum hourly wage; or c) annual compensation of $31,200, adjusted for inflation.[30] Under House Bill 4399, "low-wage employee" would mean either of the following: a) a minor, or b) an employee as defined under the Fair Labor Standards Act who receives annual wages from the employer at a rate that is less than 138% of the last published Federal poverty line for a family of three individuals.[31]

In addition to the efforts described above, at least 11 other states within the past 10 years have implemented statutory income restrictions on noncompete agreements. Those states and the income restrictions are outlined in Table 1.

Table 1

State	Restriction	Effective Date
Colorado	Void, except for "highly compensated workers" ($101,250/year)	10-Aug-22
Illinois	Void, unless actual/expected earnings exceed $75,000/year	1-Jan-17
Maine	Void, unless earnings exceed 400% Federal poverty level	19-Sep-19
Maryland	Void, unless earnings exceed $15/hour or $31,200/year	1-Oct-19
Massachusetts	Unenforceable against nonexempt workers under FLSA	14-Jan-21
Nevada	Void for hourly workers	1-Oct-21
New Hampshire	Void, unless earnings exceed 200% of Federal poverty level	8-Sep-19
Oregon	Void, unless gross compensation exceeds $100,533	1-Jan-22
Rhode Island	Unenforceable against nonexempt workers under FLSA	15-Jan-20
Virginia	Unenforceable against employees earning less than VA average weekly wage	1-Jul-20
Washington	Void, unless employee earnings exceed $100,000; independent contractors, $250,000	1-Jan-20

Limitations by Profession

Another area in which noncompete agreements have been restricted is by profession or occupation. Typically, when restricted or prohibited in this manner, the restrictions apply only to a few professions. For example, in Delaware,

> Any covenant not to compete provision of an employment, partnership or corporate agreement between and/or among physicians which restricts the right of a physician to practice medicine in a particular locale and/or for a defined period of time, upon the termination of the principal agreement of which the said provision is a part, shall be void….[32]

In the early-2000s, a number of states (e.g., Illinois, Connecticut, and Arizona) implemented noncompete agreement restrictions for broadcasters. Recently introduced or enacted measures across the country have proposed exceptions to enforceability for noncompete agreements for a variety of occupations or professions, including, e.g., health professionals, employees of a technology business, and veterinarians.[33]

Some profession-based restrictions on noncompete agreements are not statutory. For example, the American Bar Association Model Rules of Professional Conduct, and many states professional conduct rules for attorneys (including Michigan's), bars attorney noncompete agreements unless the restriction is incidental to sale of a law practice.[34] Another relatively longstanding restriction can be found in Alabama, which allows certain noncompete agreements, but based on a combination of statutory authority and case law, prohibits the enforcement of noncompete agreements against "professionals". As that term is not defined, it has been up to the courts in Alabama to do so. To date, the term has been interpreted to include attorneys, veterinarians, accountants, several specialties of physician, and physical therapists.

Other Limitations or Restrictions

Recently, other states have adopted other restrictions on employer-employee noncompete agreements. For example, Washington and Oregon limit the enforceable duration of noncompete agreements to 18 months and one year, respectively.[35] Some states (for example, Maine, Massachusetts, New Hampshire, Oregon, and Washington) have enacted statutes requiring an employer to notify a prospective employee or applicant that his or her employment will be conditioned on entering into a noncompete agreement. Michigan Senate Bill 143 and House Bill 4399 for the 2023-24 session propose similar requirements. In addition, the Michigan bills would void choice-of-laws provisions that would allow parties to "contract around" protections granted by the bill.

Other proposals to restrict the enforceability of noncompete agreements or modify the bargaining position of parties to the agreement include the following:

- Requiring additional consideration to be provided in exchange for an agreement (especially one executed after a worker has begun working).[36]
- Limiting enforcement if the employer terminates the employee without cause.[37]
- Allowing or requiring "garden leave", i.e., essentially keeping an employee on payroll in a post-employment period in exchange for that employee not working anywhere.[38]

Enforcement

Recently, states have used their consumer protection or antitrust laws to prevent businesses from using overbroad noncompete agreements. In 2016, the Attorney General of Illinois sued Jimmy John's for alleged violations of the Illinois Consumer Fraud and Deceptive Business Practices Act for its use of indiscriminate noncompete agreements nationwide. Later that year, Jimmy John's settled with both the states of Illinois and New York (which had sued Jimmy John's under similar circumstances).[39]

In comments in response to a Federal Trade Commission (FTC) workshop on noncompete agreements, several state attorneys general (particularly those in Washington, New York, and Illinois) noted that their states had settlement agreements with individual or groups of businesses that had employed noncompete agreements in violation of their states laws.[40] These public comments also encouraged the FTC to engage in rulemaking on the subject of noncompete agreements, particularly with respect to low-wage workers who do not have access to trade secrets or "competitively sensitive" information.[41]

FEDERAL ACTION RELATED TO NONCOMPETE AGREEMENTS

Federal Activity, Litigation, & Enforcement, Generally

In recent years, the Federal government has increased its scrutiny of noncompete agreements. Over the last decade, the FTC has focused on noncompete agreements after research on the subject raised concerns about the effects of noncompete agreements on labor and other markets. In 2018 and 2019, the FTC held several hearings on consumer protection and competition, and invited public comment on, among other things, the use of noncompete agreements. In 2019, a group of labor and public interest organizations, scholars, and individual advocates petitioned the FTC to commence rulemaking to curtail noncompete agreements. In addition, the FTC has completed several other workshops and solicited public comment for potential rulemaking on noncompete clauses.

Restricting noncompete agreements has seen increased interest from the White House. In 2016, President Barack Obama, in furtherance of an executive order he issued related to increasing competitiveness, called on states to adopt "best practices" for state noncompete agreement reform.[42] In an executive order signed July 9, 2021, President Joe Biden stated that "[p]owerful companies require workers to sign non-compete agreements that restrict their ability to change jobs".[43] To address this issue, the order encourages the Chair of the FTC "to consider working with the rest of the Commission to exercise the FTC's statutory rulemaking authority under the Federal Trade Commission Act to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility".[44]

Concurrent with these efforts, the Federal government has stepped up the enforcement of antitrust laws (mainly using the Federal Trade Commission Act), as demonstrated by several recent cases. On December 28, 2022, the FTC accepted consent agreements from two glass manufacturers (O-I Glass, Inc. and Ardagh Group S.A.) that allegedly required various employees to enter into restrictive noncompete agreements that banned employees from accepting a job in the glass industry anywhere in the United States for one to two years after leaving those companies.[45] The rationale for enforcement action in that case was the unusual concentration of the glass industry. On the same day, after an investigation lasting over a year, the FTC also accepted a consent agreement from Prudential Security, Inc. and Prudential Command Inc. The FTC's complaint alleged that the companies took advantage of their superior bargaining position against security guards, who typically earned minimum wage, by subjecting them to noncompete agreements. In particular, if an employee broke the agreement by working for a competitor within 100 miles of a Prudential jobsite, the agreement required the breaching employee to pay $100,000 in penalties. These cases, and others, all have involved (either as a primary or incidental matter) those businesses' use of noncompete agreements.[46]

Most recently, on May 30, 2023, the National Labor Relations Board's General Counsel issued a memorandum stating that it was her belief that proffering, maintaining, and enforcing noncompete agreements in employment or severance agreements violates the National Labor Relations Act (NLRA) in most circumstances.[47] The memorandum notes that Section 7 of the NLRA states that employees have the "'right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection,'" or to refrain from those activities.[48] The interference of these rights is an unfair labor practice in violation of Section 8(a)(1) of the NLRA. Noncompete agreements, the memorandum contends, chill the exercise of employees' Section 7 rights unless they are narrowly tailored to address specific circumstances that justify the infringement of those

rights. The memorandum does note that noncompete agreements might be justified under certain situations, such as when the agreements "clearly restrict only individuals' managerial or ownership interests in a competing business, or true independent-contractor relationships", or other special circumstances.[49]

Federal Trade Commission Rulemaking

On January 5, 2023, the FTC issued a notice of proposed rulemaking (NPRM).[50] In the NPRM, the FTC stated its preliminary determination that noncompete agreements are an unfair method of competition, and its intention to use its authority under Sections 5 and 6(g) of the Federal Trade Commission Act to propose the "Non-Compete Clause Rule".[51] The FTC contends that noncompete agreements are unfair in that they are "restrictive conduct that negatively affects competitive conditions", and are "exploitative and coercive" at the time of contracting and at the time of the worker's departure "while burdening a not insignificant volume of commerce".[52] As required under Section 5 of the FTC Act, an unfair method of competition must be "unfair" and "a method of competition".[53] As to the latter element, the FTC notes that, "When an employer uses a non-compete clause, it undertakes conduct in a marketplace. This conduct implicates competition; indeed, it has demonstrable effects on competition in both labor markets and markets for products and services."[54]

Under the proposed rule, the FTC declares that it would be an unfair method of competition for an employer to enter into a noncompete agreement with a worker, to maintain with a worker a noncompete agreement, and, generally, to represent to a worker that he or she is subject to a noncompete agreement. "Worker" is defined broadly, and would include, e.g., employees, independent contractors, interns, and volunteers. Also, the proposed rule would preempt state laws governing noncompete agreements (to the extent they provided less protection than the proposed rule). In short, the rule would amount to a categorical ban on noncompete agreements, with a limited exception for those who might employ a noncompete agreement in the context of a business purchase or sale. The proposed rule would require employers who have noncompete agreements in place to rescind them. Critically, the rule would define "non-compete clause" as:

> (1) …a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer.
> (2) The term non-compete clause includes a contractual term *that is a de facto non-compete clause* because it *has the effect* of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer [emphasis added].[55]

Agreements meeting this threshold might include broad nondisclosure agreements or training repayment agreements, especially if the amount required to be repaid is substantial or does not bear a reasonable relationship to the actual cost of the training.

The proposed rule faces an uncertain future. The original comment period for the proposed rule closed on March 20, 2023; however, the FTC extended the comments period to April 19, 2023.[56] When the comment period closed on April 19, 2023, the proposed rule had received over 16,000 comments. Going forward, the FTC could 1) promulgate the rule as-is, 2) do nothing, or 3) revisit the rule based on comments and modify its scope. As the FTC notes in the NPRM, a ban more limited in scope may accomplish its stated goals of facilitating

competition in industry and labor markets while still allowing businesses an avenue to protect legitimate business interests, particularly for highly compensated individuals or executives.[57]

Moreover, a number of interest groups, including the US Chamber of Commerce, have signaled their intentions to sue the FTC if it proceeds with a broad ban on noncompete agreements.[58] Any lawsuits in this arena could proceed under one or more of several theories, including the specific contours of the FTC's rulemaking authority,[59] or the United State Supreme Court's "major questions" doctrine.[60] The rulemaking effort also may be constrained by the Federal appropriations process or other efforts by Congress. Lastly, it is possible that if the FTC did successfully promulgate an enforceable noncompete agreement rule, it could be rescinded by a subsequent presidential administration.

Congressional Action

Although both states and the Federal executive branch have actively engaged the matter of noncompete agreements, Congressional efforts over the last five years have been limited, and no proposals have advanced beyond introduction and referral. The Workforce Mobility Act represents the most sustained effort to address noncompete agreements, introduced by members of the United State House of Representatives and the Senate in their respective chambers in each of the last several sessions.[61] The proposed Act would prohibit the use of noncompete agreements with any individual who is employed by, or performs work under contract with, a person with respect to the activities of that person in or affecting commerce. The legislation would include limited exceptions for the sale of goodwill or ownership interests of a business entity and the use of noncompete agreements within the context of a partnership dissolution or disassociation. The proposal would allow the FTC and the US Department of Labor to enforce the bill jointly, would allow the states to enforce the bill's prohibitions, and would allow individuals aggrieved by a violation a private right of action against the violating party.[62] None of the versions of this bill introduced over the last four sessions have moved beyond introduction and referral to a committee.

Also, Senator Marco Rubio has introduced the "Freedom to Compete Act" in multiple sessions.[63] The Freedom to Compete Act would amend the Fair Labor Standards Act of 1938 to prohibit the enforcement of noncompete agreements against employees. The Act also would retroactively void noncompete agreements entered into before the Act's enactment. The Act would not apply to employees employed in a bona fide executive, administrative, or professional capacity, or in the capacity of outside salespersons. As with the proposed Workforce Mobility Act, none of the versions have moved beyond introduction.

Aside from the proposed Workforce Mobility and Freedom to Compete Acts, Congressional action related to noncompete agreements since the 115th Congress (i.e., 2017-2018) has primarily reflected some limited-scope bills that would govern certain noncompete agreements. Some of these bills would have prohibited an employer from enforcing a noncompete agreement with an employee, or former employee, who has been fired for not receiving a COVID-19 vaccine (e.g., EVEN Act, HR 527 (2023-24)). The This Land Is Our Land Act (S 684 (2023-24)), in pertinent part, would nullify a noncompete entered into between a covered foreign entity (i.e., individuals and entities affiliated with China or the Chinese Communist Party) that owns or leases an interest in United States agricultural land and an employee of the covered foreign entity. Lastly, the VA Hiring Enhancement Act (see, e.g., HR 3401 (2021-22)), generally would prohibit enforcement of a noncompete agreement that an applicant for a specified appointee position, such as a physician, with the Veterans Health Administration (VA) has entered into with a non-VA facility.

CONCLUSION

Noncompete agreements are restrictive agreements that historically have been disfavored but tolerated in most states. At present, the enforceability of noncompete agreements typically is governed by state law but is subject to Federal antitrust law. While potentially effective at protecting trade secrets, sensitive information, and investments in worker training, noncompete agreements likely have tradeoff costs in the form of reduced worker wages and restricted labor markets. Economic and legal literature have not reached a consensus on the conclusion that noncompete agreements are a net benefit or detriment to the economy as whole. As this paper demonstrates, recent action nationwide governing the enforceability of noncompete agreements demonstrate increased skepticism of (if not hostility to) noncompete agreements. In particular, the FTC's recent push to ban noncompete agreements under most circumstances represents the most sweeping effort under current consideration.

[1] This principle was articulated in the 1414 case referred to as *Dyer's Case*.
[2] 24 Eng. Rep. 347 (Q.B. 1711).
[3] MCL 445.774a.
[4] The Michigan Supreme Court, in *Innovation Ventures v. Liquid Mfg.*, 499 Mich. 491 (2016), specifically disclaimed this approach for evaluating noncompete agreements between business entities.
[5] MCL 445.772. It is important to note that Michigan courts have read a reasonableness standard into Section 2's provisions (i.e., courts will only act against *unreasonable* restraints of trade). Also, see *id*.
[6] *Innovation Ventures*, at 514 (quoting *State Oil Co. v Khan*, 522 US 3, 10 (1997)).
[7] Institute of Continuing Legal Education, "Enforcing Noncompetition Agreement Claims", *Employment Litigation in Michigan*, 3rd edition, 2019.
[8] 15 USC 1.
[9] The Sherman Antitrust Act also allows US District Attorneys to proceed against violations by instituting proceedings in equity to restrain or enjoin anticompetitive conduct in violation of the Act. See 15 USC 4.
[10] According to the FTC, some 17 cases have been brought under Section 1 of the Sherman Antitrust Act *or analogous state law*; only two of these cases were successful by any metric. See also Eric A. Posner, *How Antitrust Failed Workers*, p. 95 (2021). Plaintiffs have had even less luck under Section 2.
[11] MCL 445.1902. Since Michigan's definitions is typical, it is cited here.
[12] See *U.S. West Commc'ns, Inc. v. Off. of Consumer Advoc.*, 498 NW2d 711, 714 (Iowa 1993) and *Confold Pac., Inc. v. Polaris Indus., Inc.*, 433 F.3d 952 (7th Cir. 2006).
[13] See n. 11.
[14] See, e.g., *Follmer, Rudzewicz & Co., PC v. Kosco*, 420 Mich. 394 (1984).
[15] Starr, Evan, Consider This: Training, Wages, and the Enforceability of Non-Compete Clauses", *ILR Review*, p. 783, 2019.
[16] Jeffers, Jessica, "The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship" *SSRN*, April 19, 2023 (finding that knowledge-intensive firms invest 32% less in capital equipment following a decrease in noncompete agreement enforcement); Johnson, Matthew and Lipsitz, Michael, "Why Are Low-Wage Workers Signing Noncompete Agreements", *Journal of Human Resources*, Vol. 57, p. 689 (2022) (finding that hair salons that use noncompete agreements train employees at 11% higher rate).
[17] Colvin, Alexander and Shierholz, Heidi, "Noncompete agreements: Ubiquitous, harmful to wages and to competition, and part of a growing trend of employers requiring workers to sign away their rights", Economic Policy Institute, 12-10-2019.
[18] Starr, Evan, *et al*. "Noncompete Agreements in the U.S. Labor Force", *Journal of Law and Economics*, Vol. 64, p.53 (2021); 88 Federal Register 3485, 1-19-2023. See also n. 22.
[19] See, e.g., Jennifer Dawkins, "The FTC's proposed ban on noncompete agreements could create a world of opportunity for entrepreneurs", *Business Insider*, 1-12-2023.
[20] See, e.g., Starr, Evan, *et al*. "Mobility Constraint Externalities", *Organization Science*, Vol. 30, p. 961, 7-18-2019.
[21] See, e.g., Johnson, Matthew, *et al*. "The Labor Market Effects of Legal Restrictions on Worker Mobility", *SSRN*, June 6, 2021. Also, see n. 15.
[22] Stephen Bronars, "FTC Evidence That Non-Competes Reduce Earnings Is Inconclusive", *Bloomberg Law*, Opinion, 3-7-2023.
[23] *Id*.
[24] Cal. Bus. & Prof. Code sec. 16601; N.D. Cent. Code sec. 9–08–06(1); and Okla. Stat. tit. 15, secs. 218.
[25] Minnesota SF 3035 (2023-24).
[26] Beck Reed Riden, LLP, "65 noncompete bills in 24 states – and (still) 4 federal bills", *JDSupra*, https://www.jdsupra.com/legalnews/65-noncompete-bills-in-24-states-and-3147068, 3-20-2023. Retrieved on 5-9-2023.
[27] *Id*.
[28] Code of Virginia § 40.1-28.7:8.

[29] See House Bill 5311 (2016), House Bill 4755 (2017), Senate Bill 483 (2019), House Bill 4874 (2019), House Bill 6031 (2022), Senate Bill 143 (2023), and House Bill 4399 (2023), all available at the Michigan Legislature website: http://www.legislature.mi.gov.
[30] S.B. 143.
[31] H.B. 4399.
[32] 6 Delaware Code § 2707.
[33] See, e.g., Indiana Public Law 165 (2023 Session) (physicians); Hawaii Revised Statutes § 480-4 (employees of a technology business); and Maine LD 688 (131st Legis. 2023) (veterinarians).
[34] ABA Model Rules of Professional Conduct 5.6; MI Rules of Professional Conduct 5.6 and 1.17.
[35] Washington, Wash. Rev. Code sec. 49.62.020(2) and Oregon, Or. Rev. Stat. sec. 653.295(3).
[36] See, e.g., Massachusetts S. 2418 (189th General Court).
[37] See, e.g., Pennsylvania Senate Bill 521 (Regular Session 2023-2024).
[38] See, e.g., Massachusetts. Gen. Laws ch. 149, sec. 24L(b)(vii) (effective Jan. 14, 2021); Oregon Rev. Stat. sec. 653.295(7) (effective Jan. 1, 2022).
[39] Daniel Wiessner, "Jimmy John's settles Illinois lawsuit over non-compete agreements", *Reuters*, 12-7-2016; Complaint, *People v. Jimmy John's Enterprises, LCC*, Circuit Court of Cook County, Illinois, No. 2016-CH-07746.
[40] "Public Comments of 19 State Attorneys General in Response to the Federal Trade Commission's January 9, 2020 Workshop on Non-Compete Clauses in the Workplace", p.6, n. 23.
[41] *Id*. at 11.
[42] The White House Office of the Press Secretary, "FACT SHEET: The Obama Administration Announces New Steps to Spur Competition in the Labor Market and Accelerate Wage Growth", October 25, 2016.
[43] Presidential Executive Order 14036, July 9, 2021.
[44] *Id*.
[45] Press Release, "FTC Cracks Down on Companies That Impose Harmful Noncompete Restrictions on Thousands of Workers", Federal Trade Commission, 1-4-2023.
[46] 88 FR 3498.
[47] Press Release, "NLRB General Counsel Issues Memo on Non-competes Violating the National Labor Relations Act", National Labor Relations Board Office of Public Affairs, 5-30-2023.
[48] Jennifer A. Abruzzo, General Counsel, "Memorandum GC-23-08: Non-Compete Agreements that Violate the National Labor Relations Act", p.1, 5-30-2023 (quoting Section 7 of the NLRA).
[49] *Id*. at p. 5-6.
[50] 88 FR 3482.
[51] 88 FR 3499. Under 15 USC 45, i.e., Section 5 of the Act, unfair methods of competition in or affecting commerce are unlawful. Section 5 also empowers and directs the FTC "to prevent persons, partnerships, or corporations…from using unfair methods of competition in or affecting commerce…." Section 6(g) (15 USC 46(g)) authorizes the FTC to make rules and regulations for the purpose of carrying out the provisions of the FTC Act.
[52] 88 FR 3499-3504.
[53] *Id*. at 3500.
[54] *Id*. at 3504.
[55] *Id*. at 3535.
[56] 88 FR 20441, 4-6-2023.
[57] 88 FR 3513.
[58] "U.S. Chamber of Commerce threatens to sue the FTC over proposed ban on noncompete clauses", *CNBC*, 1-12-2023.
[59] Dykema Gossett LLP, "The Federal Trade Commission's Proposed Rule Banning Employment Non-Competes—What It Means and How Businesses Can Prepare Now", Webinar, March 21, 2023 (in part outlining legislative history of the Federal Trade Commission Act and its subsequent amendment by the Magnuson-Moss Act, which gives rise to uncertainty whether the FTC has rulemaking authority for unfair methods of competition).
[60] Under the major questions doctrine, the US Supreme Court rejects agency claims of regulatory authority when 1) the underlying claim of authority concerns an issue of "vast 'economic and political significance,;" and 2) Congress has not clearly empowered the agency with authority over the issue. *UARG v. EPA*, 573 US 302, 324 (2014). Given the ad hoc manner in which Court has applied this test, it is unclear whether the FTC's proposed rule would survive it.
[61] HR 5631 and S 2782, 115th Congress; HR 5710 and S 2614, 116th Congress; HR 1367 and SR 483, 117th Congress; HR 731 and S 220, 118th Congress.

[62] See, e.g., HR 731 and S 220.
[63] S 124, 116th Congress; S 2375, 117th Congress; and S 379, 118th Congress.