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Client Alert: NLRB Announces that many Non-Compete Agreements are now in Violation of Federal Law

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Shumaker recently published a Client Alert about the Federal Trade Commission's (FTC) proposed rule essentially banning the use of non-competition agreements. In that Alert we advised clients that they should take a "wait and see" approach, as there would be a lengthy delay in the issuance of a final rule and such rule was likely to face significant legal challenges to its enforceability. Unfortunately, a second federal agency, the National Labor Relations Board (NLRB), is now also seeking to invalidate the use of many non-competition agreements. While employers can still take a wait and see approach to the FTC's efforts, the NLRB's actions require immediate attention from all employers.

What Happened?

The NLRB is the federal agency that administers the National Labor Relations Act (NLRA). The NLRA is a federal law that provides employees with rights to collectively act for their mutual benefit, including striking and unionization. However, the NLRA applies to nearly all private employers with or without union employees, and non-union employees have equal rights to engage in concerted protected activity for their mutual benefit.

On May 20, 2023 the General Counsel of the NLRB issued Memorandum 23-08. This memorandum is not binding law, but instead provides a foreshadowing of the NLRB's policy-making and prosecutorial goals. In the Memorandum the General Counsel provided that, except in limited circumstances, "the proffer, maintenance, and enforcement" of non-competition agreements violate the NLRA. Per the General Counsel, the use of non-competition agreements interfere with employees' ability to engage in protected concerted activity by discouraging them from:

- concertedly threatening to resign to demand better working conditions;
- collectively resigning to obtain improved working conditions;
- seeking or accepting employment with a competitor to obtain better working conditions;
- soliciting co-workers to join a competitor to obtain better working conditions; and

- obtaining employment at a competitor to engage in unionization and other protected concerted activities.

The General Counsel stated that non-competition provisions imposed on low or middle wage employees will nearly always be in violation of the NLRA unless the employee has significant access to the employer's trade secrets or other protectable interests. The Memorandum does not define what constitutes "low or middle wage," but cited to statistics regarding the use of non-competes with employees making less than $40,000.

The Memorandum does not just apply to low or middle wage employees however. The General Counsel opined that non-competition provisions in general will be in violation of the NLRA unless the employer can prove a legitimate business interest supporting a special circumstance justifying the infringement on the employee's rights. As to what kinds of legitimate business interests may justify a non-competition provision, the General Counsel indicated that many of the interests, which would permit enforcement of a non-compete under state law, may not be sufficient under the NLRA. Specifically, the General Counsel stated that the desire to retain employees or significant investment in training an employee are "unlikely to ever justify an overbroad non-compete provision" as employers could address these interests in other ways, such as with a retention bonus. Further the General Counsel provided that an employee's access to confidential information or trade secrets may not support a non-competition agreement as the employer's concerns could be addressed with a less restrictive confidentiality agreement.

What is Still Allowed?

Not all non-competition provisions will violate the NLRA. Specifically, the General Counsel stated that provisions that "clearly restrict only individuals' managerial or ownership interests in a competing business, or true independent-contractor relationships" may not be in violation of the NLRA.

Further, supervisors generally do not have rights under the NLRA to engage in concerted protected activity. Therefore, non-competition provisions with a supervisor should not subject an employer to liability under the NLRA. Under the NLRA, a "supervisor" is defined as "any individual having authority, in the interest of the employer, to hire, transfer, suspend, lay off, recall, promote, discharge, assign, reward, or discipline other employees, or responsibly to direct them, or to adjust their grievances, or effectively recommend such action, if in connection with the foregoing the exercise of such authority is not of a merely routine or clerical nature, but requires the use of independent judgment." If challenged it will be the employer's burden to prove that the employee meets the definition of a supervisor.

The memorandum does not address customer non-solicitation provisions so the use of such provisions may not violate the NLRA. The memorandum is also silent as to whether substantial customer relationships may constitute a protectable business interest that would justify the use of a non-competition provision.

What Should Employers Do Now?

It is anticipated that the General Counsel's Memorandum will result in a significant increase in NLRB Charges as to non-competition provisions. In fact the General Counsel in the memorandum specifically instructed the NLRB's regional offices to submit such cases for review. The General Counsel also instructed the regional offices to "seek make-whole relief for employees who, because of their employer's unlawful maintenance of an overbroad non-compete provision, can demonstrate that they lost opportunities for other employment, even absent additional conduct by the employer to enforce the provision." In other words, employees may have a right to damages from their employer because they did not apply for another better paying position even though the employer took no efforts to enforce the non-compete provision. Employers should anticipate that not only will they risk an NLRB Charge when they attempt to enforce a non-compete, but

some employees may also proactively file Charges in order to obtain a monetary recovery from their employer.

In light of the potential risk with the continued maintenance of non-competition provisions, employers should consider taking the following actions:

- seriously consider rescinding any existing non-competition provisions imposed upon employees making less than $40,000 per year;
- consult legal counsel to evaluate the benefits and risks with the continued use of non-competition provisions with non-supervisors, regardless of compensation level, and determine if effective protection can be obtained with the use of customer non-solicitation and confidentiality provisions;
- based upon the General Counsel's identification of an employee's right to solicit other employees to leave and join them at a competitor as concerted protected activity, consider rescinding employee non-solicitation provisions with non-supervisors;
- consider adding a carve out to any restrictive covenant agreements used by the employer stating that the agreement's restrictions do not preclude protected concerted activity under the NLRA; and
- prior to sending a cease and desist letter or otherwise attempting to enforce a non-compete against a non-supervisor, consult legal counsel as to the potential risks and cost of a NLRB Charge.

Shumaker will continue to monitor the NLRB's activities and we are available if you have any questions about your current non-compete agreements.

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