Proposed Non-Compete Ban May Disrupt Staffing Arrangements of US Operations

Even when there isn’t a labour shortage, companies must invest significant resources to recruit, hire and train skilled personnel for leadership roles. You then have to entrust them with your most sensitive trade secrets so they can do their jobs. This can all end up exploding in your face if that person in whom you invest so much leaves the company and uses the knowledge, skills and business assets you’ve provided to compete against you.

For these reasons, most companies insert a “non-compete agreement” or clause into the employment contract banning employees from competing against them after their employment ends. While problematic, these clauses are enforceable in Canada if you draft them right. But if a proposed new rule gets adopted, use of these clauses by your US operations may become illegal.

Non-Compete Agreements & Their Business Significance

Non-compete agreements ban employees in key leadership and management positions from engaging in business—either alone or for another company—that competes with the employer, typically within a defined geographical area for a set period of time (generally 1 to 3 years) after the contract ends. While they protect employers, non-competes also restrain trade.

Explanation: In a capitalist society, employers must have the freedom to hire employees that have the qualifications, experience and skills they need without having to worry about their contractual obligations to former employers. Employees must also be free to pursue careers in their chosen field without being shackled by the terms of a non-compete. For these reasons, courts in Canada and the US have historically frowned on non-competes and been reluctant to enforce them unless they’re narrowly drafted.

The Newly Proposed US Non-Compete Rule

Enforcing non-competes in the US would go from difficult to impossible if the Biden administration gets its way. On July 9, 2021, President Biden issued an Executive Order setting out measures to promote economic growth and competition by, among other things, encouraging the Federal Trade Commission (FTC) to ban or limit non-compete

agreements in employment contracts.

On January 5, 2023, the FTC responded to this "encouragement" by publishing a Proposed Rule that providing that non-compete clauses are an unfair method of competition and banning employers from entering into them with their employees and independent contractors. The scariest part is that the proposed rule would also require employers to rescind their **existing non-compete agreements** and "actively inform" employees that the agreement is no longer in effect.

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> Closer to home, there's one Canadian province that has also banned non-competes: Ontario. Section 67.2 of the Ontario *Employment Standards Act* makes it illegal for employers to enter into a "non-compete agreement," defined as "an agreement, or any part of an agreement. . . that prohibits the employee from engaging in any business, work, occupation, profession, project or other activity that is in competition with the employer's business after the employment relationship between the employee and the employer ends."
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> But the Ontario rule is much less broad and stringent than the proposed US rule to the extent that unlike the latter, the former:
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> - Covers new contracts but not existing ones—in other words, it doesn't require employers to go back and revise current contracts with non-competes retroactively;
> - Includes exceptions allowing for existing non-competes to continue to apply after the sale of a company; and
> - Makes an exception allowing for non-competes with "executives," defined as "any person who holds the office of chief executive officer, president, chief administrative officer, chief operating officer, chief financial officer, chief information officer, chief legal officer, chief human resources officer or chief corporate development officer, or holds any other chief executive position."
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> In general, any restrictions on employee competition in Canada should be structured as non-solicitation rather than non-compete agreements.

How the Rule Will Impact US Staffing

The impact of the rule, should it take effect in its present form, will be massively disrupting to staffing and employment especially in the healthcare, technology and other industries where non-competes have been a staple of employment contracts for many decades. Most reasonable people would acknowledge that non-compete agreements thwart competition and the freedom of employees to ply their trade. But while these are problems that need to be addressed, what's required is an appreciation of context and the legitimate and reasonable purposes that non-competes serve. But instead of a scalpel, the FTC is wielding a sledgehammer, proposing a ban that would apply regardless of employee type, compensation, industry or any other contextual factors.

In addition to being highly disruptive to staffing operations in the US, there are also legitimate questions about the FTC's legal authority to impose a one-size-fits-all rule for all employees across all industries. Regulation of employment contracting, including non-compete agreements, is a domain that has historically been

left to the states. Should it take effect, the FTC rule would supersede all of these state laws that are inconsistent with the rule's provisions. Nor does the FTC point to any statute in which Congress granted the agency the power to implement such a sweeping rule.

Even if the FTC did have the legal authority to issue the rule, many believe that now is not the time to upend the skilled labour markets that are currently getting battered by inflation and shortages. At the very least, any rule that the FTC finalizes should specifically exempt key positions like professionals, senior executives and other highly-skilled, highly-compensated employees.

Takeaway: What Companies Should Do

Companies that operate in the US with US employees need to be aware of the proposed FTC rule and its potential impact while waiting to see what happens next. Keep in mind that this is just a proposed rule and that the agency has received a flood of public comments. The FTC still has to finalize the rule on the basis of these public comments. It will also take at least a couple of years before a final rule would take effect. Even so, while there may be gradations, exceptions and other changes, experts expect that some form of the FTC rule will go into effect in the US eventually.

Under the current parameters, companies would be in violation of the rule if they:

- Enter into a non-compete with a worker;
- Seek to enter into a non-compete with a worker, even if those efforts don't come to fruition; and/or
- Maintain a non-compete agreement.

Accordingly, attorneys suggest using this as an opportunity to go through your current US employment agreements to determine whether they include any non-compete provisions that will have to be eliminated or amended if the FTC rule took effect.

Also Beware of Hidden Non-Competes

Although the rule doesn't ban other forms of what are known as "restrictive covenants," such as non-disclosure and non-solicitation clauses commonly found in employment contracts, these provisions may still be problematic if they have the effect of a non-compete agreement. In other words, it's not what you call the agreement but the types of restrictions it actually imposes that will determine whether a contract clause constitutes an illegal non-compete agreement under the FTC rule. Unfortunately, the FTC has no current guidelines for determining whether a non-solicitation, non-disclosure or other restrictive is actually a non-compete.

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> Legal authority for the FTC non-competes ban comes from Section 5 of the FTC Act, which prohibits "unfair or deceptive acts or practices in or affecting commerce" committed by "persons, partnerships, or corporations" who are engaged in commerce. It's well established that the Section 5 ban doesn't apply to nonprofits. Accordingly, companies that are nonprofits would presumably be exempt from the ban.
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> Nonprofit status for purposes of applying Section 5 is based not just on an entity's tax-exempt status but on how it actually operates. Thus, companies primarily dedicated to charitable purposes could be exempt from Section 5 even if they're not

tax-exempt; similarly, tax-exempt companies may be deemed not to be nonprofits to the extent their business operations and missions are profit-based.