NON-COMPETE RESTRICTIONS—END OF AN ERA FOR EMPLOYERS?

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What are Non-Competes and What Do They Do?

Restrictive covenants in some form have been included in employment agreements and enforceable by employers, including dentists, against their employees for decades. **They are generally described to include the following types of restrictions: non-compete provisions, non-solicitation provisions, and confidentiality/non-disclosure provisions, including trade secrets protection.** Their purpose has been—and still is—to protect the legitimate business interests of employers while not preventing an employee from their own livelihood. State courts have repeatedly supported the use of restrictive covenants in employment with some exceptions. The use and enforcement of restrictive covenants are currently controlled by state law and while state court tolerance in regard to the nature and breadth of the restrictions vary across the United States, they are at the time of this article, enforceable in all 50 states in some form or another.

Non-compete provisions (often referred to as time and distance restrictions) are employment restrictions that limit an employee's or former employee's ability to work within a certain geographical area for a specific period of time. From an employer perspective, these non-compete restrictions are intended to protect their business against unfair competition. Conversely, these non-compete restrictions are usually considered the most restrictive of covenants and disabling for an employee by interfering with their freedom of mobility and ability to work. State courts have generally supported non-compete provisions if they are reasonable in their scope (known as the reasonableness standard), as to time, geography and the activities they restrict. If the court finds them to be unreasonable, albeit overly broad, then depending on the jurisdiction, the court may either not enforce it, reform it, or strike the unenforceable portions.

The following are examples of two different state court reviews of non-compete provisions in the dental setting. Both cases involve protecting an employer's legitimate business interest, but draw different conclusions as to what is reasonable and therefore enforceable:

- In *Terry D. Whitten, D.D.S., P.C., v. Malcolm*[1], the employer (Whitten) sought injunctive relief to restrain and prohibit the employee (Malcolm) from practicing dentistry in the geographic area (25-mile radius) and time period (one year) restrictions of the non-compete provisions within their employment agreement. The Nebraska Supreme Court used a three-part test when considering the validity of a covenant not to compete: 1) "[I]s the restriction reasonable in the sense that it is not injurious to the public"; 2) "[I]s the restriction reasonable in the sense that it is no greater than is reasonably necessary to protect the employer in some legitimate interest"; and 3) "[I]s the restriction reasonable in the sense that it is not unduly harsh and oppressive on the employee".[2]

  The court concluded that Whitten had a legitimate interest in protecting the existing client base from unfair competition because there was evidence that the employee "had the opportunity to abscond with Whitten's goodwill in the form of patients."[3] However, it further concluded that the non-compete provision was unreasonable and unenforceable because it overreached by extending to anyone in the restricted geographic area not just Whitten's existing client base. Finally, the court found that it was not within its function to reform the unreasonable covenant to make it enforceable.

- In *Dental East, P.C. v. Westercamp*[4], there was a non-compete agreement restricting practice for the employee within a 20-mile radius over a two-year period and if breached required payment to employer by the employee of 40 percent of whatever production resulted from the employee's provision of dental services for a patient of record for a one-year period. In assessing whether the agreement was unduly restrictive, the Iowa court followed the established state rule: "we will enforce a noncompetition provision in an employment contract if the covenant is reasonably necessary for the

protection of the employer's business and is not unreasonably restrictive of the employee's rights nor prejudicial to the public interest …. Although we must afford fair protection to the business interests of the employer, the restriction on the employee must be no greater than necessary to protect the employer. Moreover, the covenant must not be oppressive or create hardships on the employee out of proportion to the benefits the employer may be expected to gain."[5] The court found it was reasonable for Dental East, P.C. to seek to protect its business. It further found the restrictions enforceable because they did not prevent Westercamp from practicing dentistry but instead provided partial compensation to the employer for services performed on patients of record at Dental East.

Despite these general provisions (legitimate business interest, restriction no greater than necessary, not preventing employee livelihood, not injurious to the public, and reasonable restrictions), there is significant variability across the states with regard to non-compete provisions. There are a limited number of states where non-compete provisions are prohibited: California, Minnesota, North Dakota, and Oklahoma.[6] Excluded from these prohibitions are non-compete provisions associated with the sale of a business. States that do not outright prohibit non-compete provisions do place varying restrictions on the enforcement of non-compete provisions through common law and/or statute based on the needs and public policy of the state.

For example, there are states that limit non-compete enforcement based on the level of compensation paid to an employee: 1) prohibited except for highly compensated employees (e.g., Colorado, District of Columbia, Oregon, and Washington)[7]; and 2) prohibited for low-wage employees (e.g., Illinois, Maine, Maryland, New Hampshire, and Virginia)[8]. Many states have provisions that ban or limit the enforceability of non-compete provisions for employees in specific professions or occupations (e.g., physicians) There are three states that specifically prohibit the enforcement of non-compete provisions for employee dentists: Arkansas, New Mexico, and South Dakota.[9] Tennessee requires that non-compete provisions with employee dentists include a written and signed agreement that includes the restrictions, a duration restriction of two years or less, and a maximum geographic restriction of a ten-mile radius from the primary practice site or the county in which the primary practice is located, or if no geographic restriction but a restriction from practicing at any facility at which the employer provided services during employment.[10]

Current Challenges to Non-Competes in Employment

While a long-standing fixture in employment arrangements, non-compete provisions are under increased scrutiny on federal and state levels. The FTC (Federal Trade Commission), in a 2023 Notice of Proposed Rulemaking, estimates that one in five American workers is subject to a non-compete provision.[11]

Federal Action

There has been some long standing opposition nationally to the use of non-competes in employment, leading to the FTC rendering their current proposal to change the Code of Federal Regulations by adding a new rule ("Non-Compete Clause Rule") to ban their use in employment.[11, 12] This action was charged by President Biden's Executive Order, Promoting Competition in the American Economy, to the FTC in 2021 that took aim against restrictive covenants.[13] The Non-Compete Clause Rule after being published in January of 2022 was open for public comment until April 2023. The FTC is anticipated to vote on the Non-Compete Clause Rule in April 2024. At the time of this writing, the expectation is that the Non-Compete Clause Rule will pass in some form despite the massive amount of opposition it received during the public comment period. Legal challenges to the Non-Compete Clause Rule, if approved, will likely ensue. The U.S. Chamber of Commerce has already threatened to sue the FTC over the Non-Compete Clause Rule, claiming that the FTC is overstepping its bounds and is without authority to take its proposed action banning non-competes in employment.[14]

In addition to the action taken by the FTC, other less publicly recognized actions have been taken against, non-compete provisions and agreements. H.R. 731 was introduced last year by Representative Peters in the United States House of Representatives as the Work Force Mobility Act of 2023 ("WMA"). The WMA seeks to prohibit the use of non-compete agreements in the context of commercial enterprises except under certain circumstances such as against a seller of a business, agreements with senior executive officials with severance agreements as a condition of the sale, or a partner of a partnership upon the dissolution of the partnership or the disassociation of the partner from the partnership. While there is a parallel bill in the United States Senate, S. 220, introduced by Senator Murphy, not much activity appears to have ensued.[15] Also in the U.S. Senate, the Freedom to Compete Act of 2023 (S.379), was introduced by Senator Rubio; this bill would prevent employers from using non-compete agreements in employment.[16]

In 2022 the National Labor Relations Board ("NLRB") entered into a memo of understanding with the FTC and the Department of Justice Anti-Trust Division, both of which have addressed the anti-competitive effects of non-compete agreements.[17] On May 30, 2023, the NLRB's General Counsel asserted that non-competes can "chill" employee's rights to take collective action to improve their terms and conditions of employment in violation of their Section 7 rights under the National Labor Relations Act.[18] These actions may result in additional unfair labor practice charges against employers.

Of particular note to physicians and dentists, the American Medical Association (AMA) adopted a policy in 2023 entitled "Prohibiting Covenants Not-To-Compete in Physician Contracts," which provides that "Our American Medical Association support policies, regulations, and legislation that prohibits covenants not-to-compete for all physicians in clinical practice who hold employment contracts with for-profit hospital, hospital system, or staffing company employers." This was distinguished from covenants not-to-compete in physician contracts with independent physician groups, which the AMA will study and report back on.[19]

State Action

In sync with the federal action described above, there is recent state level activity seeking to prohibit the use of non-compete provisions. In California, a state that already prohibited non-compete provisions, recent legislation was enacted to make the prohibition clearer and expand the enforcement. A new notice requirement required employers to notify current and former employees in individualized written communications by Feb. 14, 2024, if their non-compete provisions are void.[20] Further, the legislation created a right of private action against an employer and recovery of reasonable attorney's fees.[21] In Illinois, Maine, and Virginia, states that currently prohibit non-compete provisions for low-wage employees, legislation is under consideration that would expand the prohibition to all employees.[22] In Maryland, there is legislation under consideration that would prohibit non-compete provisions for employees required to be licensed under the Health Occupations Article (including dentists).[23]

This is not intended as a comprehensive summary of state activity, but rather a snapshot of the trending direction.

What Does All of this Mean for Dentist Employers?

Assuming the FTC Non-Compete Clause Rule is adopted as currently written, employers will have to consider and take action.[24] This will include informing all of their current and former employees with non-compete restrictions that the employee's non-competes are no longer valid and are null and void under the Non-Compete Clause Rule. The Non-Compete Clause Rule will be effective 60 days after date of publication of the final rule, and compliance with the notice provision will be required 180 days after date of publication of the final rule, unless enjoined. This should prompt employers to begin looking at all of their current agreements with employees and former employees and consider modifications to make their current and any future employment agreements comply with the Non-Complete Clause Rule.

Regardless of whether or not the FTC Non-Complete Clause Rule is adopted and survives legal challenges, pediatric dentist employers should pro-actively engage in some best practices regarding the use of restrictive covenants with their employees.[25] Some examples to consider include:

- Conduct an audit of current and former employees subject to non-compete restrictions and begin planning for the potential of imposed notice requirements.
- Conduct a risk/benefit analysis with employer's legal counsel to determine the least restrictive form of restrictive covenants that an employer can use that will be enforceable to protect the employer's business interests. Overly broad restrictive covenants against employees will most likely be found unreasonable and may lead to an employer's hesitation in taking legal action to enforce them.
- Draft restrictive covenants that are reasonably expected to be enforceable in the jurisdiction being used and the employer is willing to take legal action to enforce them. **Repeatedly failing to enforce restrictive covenants against employees who have violated them may erode their enforceability against other employees with similar restrictions.**
- Protect the trade secrets of the practice business by only exposing these trade secrets to employees as necessary for them to perform their duties as an employee. **The use of confidentiality and non-disclosure provi-**

sions remain protected in most states and are not the target of the Non-Compete Clause Rule-- provided they are not in effect or de facto a non-compete restriction. The draft Non-Compete Clause Rule provides two examples of de facto non-compete clauses: 1) "a non-disclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer" and 2) "a contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker."[24]

- Know the laws that govern restrictive covenants in the employer's state (s) of conducting their business. Some states will have laws governing the use of these restrictions while others defer to state case law for judicial guidance on their use and enforcement. If the Non-Compete Clause Rule is passed, then only state laws more restrictive than the new Non-Compete Clause Rule will be governing.
- Incorporate drafting strategies (by employer's legal counsel) that may allow for greater success enforcing restrictive covenants such as choice of law, drafting each restriction as separate and apart from the other (including contractual restrictions such as waiving rights to jury trial) and making sure adequate consideration is provided to the employee as may be required under governing law.
- Include strategies to retain employees such as competitive compensation and benefits, as well as relocation or sign-on bonuses that are paid over time and require continued employment to receive them.

The Future Landscape for Employer's Use of Restrictive Covenants

Given the ever increasing federal and state attention directed toward non-compete provisions in the employment context, it is incumbent on employers to remain informed about changes impacting the use of all restrictive covenant provisions in their practices and to take appropriate action. Employers may be required to quickly implement changes in order to comply with regulatory requirements. As already emphasized, the FTC Non-Compete Clause Rule if adopted will include retroactive effect. Employers should engage in a review with legal counsel of their use of all restrictive covenants in the context of employment, including the hire of independent contractors. Such review should include: 1) analyzing the effect that regulatory change and case law precedent may have on their current use of restrictive covenants, and in particular non-compete provisions, in the employment/hiring context; and 2) incorporating best practices to align the use of such restrictions with current federal and state law to protect the employer's ability to enforce them. If there was ever a time to think proactively and critically about the use of restrictive covenants in employment, the time is now.

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This column presents a general informational overview of legal issues. It is intended as general guidance rather than legal advice. It is not a substitute for consultation with your own attorney concerning specific circumstances in your dental practice. Mr. Litch does not provide legal representation to individual AAPD members.

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21. Cal. Bus. & Prof. Code §16600.5 (2024).
22. H.B. No. 5385, 103rd Gen. Assem., 2d Reg. Sess., (Ill. 2023), H.P. No. 951, 131st Leg. 1st Spec. Sess. (Me. 2023), and S.B. No. 360, Reg. Sess. (Va. 2024).
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