

Insights

FTC Proposes Rule to Ban Non-Compete Agreements

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By: Scott S. Morrisson and Elizabeth M. Roberson

On January 5, 2023, the FTC issued a **proposed rule** that purposes the ban of virtually all non-compete agreements, including those entered into before the rule takes effect. This breaks the silence from the FTC on this subject and is a direct response to the **Executive Order issued by the Biden Administration** in July 2021 which asked the FTC to act against anti-competitive behavior. The FTC voted 3-1 to publish this proposed rule and those in favor stated, “[the Notice of Proposed Rulemaking] marks the [FTC]’s commitment to exercising the full set of tools and authorities that Congress gave [it] and to ensuring that our work is protecting all Americans.” However, as FTC Commissioner Christine S. Wilson notes in her strong dissenting statement, the “proposed Non-Compete Clause Rule represents a radical departure from hundreds of years of legal precedent that employs a fact-specific inquiry into whether a non-compete clause is reasonable”

The proposed rule is open for public comment for 60 days. Employers interested in commenting may submit comments during that comment period. After the comment period, the FTC will review the comments, make any necessary changes, and finalize the rule. Once finalized, the rule would become effective 180 days after the final version is published.

1. The Proposed Rule

The proposed rule adds a new subchapter titled “Rules Concerning Unfair Methods of Competition” to Title 16 of the Code of Federal Regulations (“CFR”). For a background, Title 16 of the CFR has rules about the operation of the FTC, the Fair Credit Reporting Act, the Magnuson-Moss Warranty Act, the Hart-Scott-Rodino Antitrust Improvement Act of 1976, the Fair Debt Collection Practices Act, and a separate Chapter regarding the Consumer Product Safety Commission. The proposed rule has various sections, each of which is detailed below.

- a. What is a “non-compete clause” and the test for determining whether a clause in a contract operates as a non-compete.

The proposed rule begins with a definition section. Notably, this section defines what constitutes a “non-compete clause” and the test for determining whether a contractual term is a non-compete, among other definitions. A “non-compete clause” is defined as “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.”

The FTC proposes a test to determine whether contractual clauses operate as non-competes and are prohibited by the proposed rule. Under the “functional test”, a “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." Examples are provided of those contractual clauses and include:

- Non-disclosure agreements written so broadly that they effectively prevent the worker from working in the same field; and
- A requirement that an employee pay the employer or third-party for training costs if the worker terminates their employment within a specified period, where the payment is not reasonably related to the costs incurred by the employer for training the worker.

b. Unfair methods of competition.

The next section of the proposed rule explains what non-compete agreements are prohibited. The rule prohibits an employer from entering or attempting to enter into a non-compete clause, maintaining a non-compete clause, or representing to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe the worker is subject to an enforceable non-compete.

The proposed rule also requires employers to rescind non-compete clauses entered into before the proposed rule takes effect. As a part of that rescission, employers must also provide notice to workers that the worker's non-compete clause is no longer in effect and may not be enforced by the employer. This notice must also be provided to workers who no longer work for the employer but who were subject to non-compete clauses. The proposed rule provides model language for this notice requirement.

c. One exception.

The only exception to the proposed rule banning non-compete clauses is for non-compete clauses entered into by a person selling a business, otherwise disposing of the person's ownership interest in the business entity, or by a person selling all or substantially all of the business entity's operating assets. However, the person restricted by the non-compete clause must be a substantial owner, member or partner, such that the person held at least 25% ownership interest in the business entity.

d. Relation to state laws.

Last, the proposed rule states it supersedes any conflicting state law, regulation, or interpretation to the extent that it is inconsistent with the proposed rule.

2. Takeaways

We expect to see a high volume of comments on this proposed rule, including strong opposition from many employers, as it represents a major shift in the law. Further, given its vast prohibitions, and look back provisions, it will also see many legal challenges if it becomes final. Thus, it is possible that employers are never required to abide by these prohibitions, or the prohibitions will be significantly diluted, but it will be important for employers to follow the rule making process and know how the proposed rule would affect their business. The FTC has asked that workers and employers comment with their specific experiences. Further, it is important for employers to understand whether this rule will prohibit clauses other than their traditional non-compete clauses, including non-disclosure clauses, non-solicitation clauses, and agreements to repay training costs. Our Labor and Employment team will continue to follow this proposed rule and any action as a result. We will issue an update once the actual rule takes effect. If you need assistance commenting on the proposed rule, auditing your current agreements, or have questions regarding the proposed rule please contact **Scott S. Morrisson, Elizabeth M. Roberson**, or another member of our **Labor and Employment team**.

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