Client Alert: Is the Sky Falling? The FTC's Proposed Ban on Non-Compete Agreements

BY ROBERT G. YOUNG • JANUARY 24, 2023

The Federal Trade Commission (FTC) recently announced a proposed new rule that would have a seismic effect on employment relationships throughout the United States, by barring the future use of non-competition agreements and requiring employers to rescind such existing agreements.

FTC'S RULEMAKING AUTHORITY AND EXISTING STATE LAWS

As published in the Federal Register on January 19, 2023, the proposed rule states that it would be an unfair method of competition for employers to enter into or attempt to enter into non-competition clauses with workers, to maintain such non-competition clauses, or, in certain cases, to represent to workers that they are subject to a non-competition clause. In the proposed rule, the FTC invokes the rulemaking authority of Section 5 and 6(g) of the Federal Trade Commission Act (the FTC Act). Section 5 of the FTC Act deems "unfair methods of competition" to be unlawful and directs the Commission to prevent the use of unfair methods of competition "in or affecting commerce." Section 6 of the FTC Act authorizes the Commission to implement rules and regulations necessary to carry out the FTC Act's purposes, including the prohibition against unfair competition.

The proposed rule notes that a number of states already have laws restricting the use of non-competition agreements. These include California, North Dakota, and Oklahoma, where non-competition agreements are barred almost entirely, but also states like Massachusetts, Rhode Island, Connecticut, New Hampshire, Maine, Colorado, Illinois, Maryland, Nevada, Oregon, and Virginia, as well as the District of Columbia, where their use is restricted.

PROPOSED DEFINITIONS OF EMPLOYERS, NON-COMPETITION CLAUSES, AND WORKERS

The proposed rule includes sweeping definitions of employers, workers, and non-competition agreements.

As defined in the proposed rule, an employer includes any natural person, partnership, corporation, association, or other legal entity, including any person acting under color or authority of state law, that hires or contracts with a worker to work for the person. As noted in the proposed rule, inasmuch as certain employers are exempted from coverage under the FTC Act (including certain banks, savings and loan institutions, federal credit unions, common carriers, air carriers and foreign air carriers), such employers will not be subject to the proposed rule. Additionally, the proposed rule states that certain state and local government entities may not be subject to the proposed rule "when engaging in action protected by the state action doctrine."

The proposed rule defines the term worker broadly. It incorporates by reference the definitions set forth in 15 U.S.C. 57b-1(a)(6). It would include both paid and unpaid employees, independent contractors, externs, interns, volunteers,

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apprentices, and sole proprietors. The FTC makes no distinction based on a worker's income or job status, asserting "non-compete clauses obstruct labor market competition in a similar way for all workers, regardless of a worker's income or job status." The proposed rule, if adopted, would impact not just employers who use non-competition clauses with their own workers, but also employers who wish to hire applicants who are subject to such restrictions. Virtually every paid and unpaid worker in the United States, from CEOs of Fortune 500 companies to unpaid volunteers, would fall under the ambit of the proposed rule.

Finally, the proposed rule's definition of non-compete clauses includes not just provisions that are denominated as non-competition clauses, but also contractual terms which could be considered de facto non-compete clauses. These would include agreements that prevent employees from working in the same line of business after separation or which require workers to reimburse an employer or third-party for the cost of training if their employment ends within a specific time period. Thus, retention bonus agreements, equity grants, and training reimbursement agreements could all be barred under the proposed rule, as the focus is not on what the clause is *named* but how it *functions*.

RESCISSION OF EXISTING NON-COMPETE CLAUSES

If enacted, the rule will not only bar the use of non-competition clauses as of the rule's effective date, but it will also retroactively bar the use of such clauses. Employers would be required to rescind all existing non-compete clauses and provide individualized notices to current and former workers within 45 days of rescission. While employers are free to draft their own rescission communication, the proposed rule includes the following model language:

A new rule enforced by the Federal Trade Commission makes it unlawful for us to maintain a non-compete clause in your employment contract. As of [DATE 180 DAYS AFTER DATE OF PUBLICATION OF THE FINAL RULE], the non-compete clause in your contract is no longer in effect. This means that once you stop working for [EMPLOYER NAME]:

- *You may seek or accept a job with any company or any person—even if they compete with [EMPLOYER NAME].*
- *You may run your own business—even if it competes with [EMPLOYER NAME].*
- *You may compete with [EMPLOYER NAME] at any time following your employment with [EMPLOYER NAME].*

The FTC's new rule does not affect any other terms of your employment contract. For more information about the rule, visit https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking.

By the FTC's own estimation, "at least one in five American workers—or approximately 30 million workers—is bound by a non-compete clause." Needless to say, the administrative impact of rescinding millions of non-compete clauses will be immense.

LIMITED SALE OF BUSINESS EXCEPTION

If adopted as written, the rule would include a limited sale of business exception. Specifically, where the party restricted by a non-compete provision is "an owner, member, or partner holding at least a 25% ownership interest" in the business being sold, that individual can be subject to a non-compete restriction.

PUBLIC COMMENT AND NEXT STEPS

The FTC has invited the public to submit comment on the proposed rule by March 20, 2023. If adopted, the FTC's proposed rule will undoubtedly face legal challenges, including as to the FTC's authority to issue the rule in the first instance. While the proposed rule hasn't yet become law, it would be prudent for employers to review their existing agreements with employees to confirm their compliance with existing state laws.

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This alert aims to provide an overview of the FTC's proposed rulemaking regarding non-competition agreements. We will continue to monitor future developments. Employers with questions should consult with their Bowditch attorneys.

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