Patterson Belknap

Employment Law Alert
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FTC Proposes New Rule Banning Non-Compete Clauses

On January 5, 2023, the Federal Trade Commission ("FTC") proposed a sweeping new rule ("the Proposed Rule") that would ban almost all non-compete clauses in agreements between employers and workers. If finalized in its current form, the Proposed Rule would prohibit employers from entering into non-compete agreements with workers and require employers to rescind any existing non-compete agreements.

Employers should immediately consider how the Proposed Rule will impact them by taking stock of any agreements they have with current or former workers. The Proposed Rule will be subject to a 60-day public comment period, after which the FTC will likely issue a final rule that may or may not differ from the current version. If the FTC adopts the Proposed Rule as it is currently drafted, employers will have only 180 days after publication of the final rule in the *Federal Register* to come into compliance. Although this timeline may change in the event of revisions and/or legal challenges (which are likely), employers should nevertheless be prepared to act quickly if and when the Proposed Rule is finalized.

Overview of the Proposed Rule

The Proposed Rule is a comprehensive prohibition on the use of non-compete clauses in agreements between employers and workers in nearly all circumstances. Under the Proposed Rule, it would be "an unfair method of competition"—and a violation of Section 5 of the FTC Act—for an employer to enter into, attempt to enter into, or maintain a non-compete clause with a worker. Employers would also be required to rescind any existing non-compete clauses with current and former workers. The Proposed Rule purports to preempt and supersede any inconsistent state laws, regulations, or rules (except where state law provides greater protections to workers).

Broad Definition of "Non-Compete Clause"

The Proposed Rule broadly defines "non-compete clause" 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 definition encompasses "*de facto* non-compete clauses," or contractual terms that may not explicitly restrict competition but nevertheless have that effect, such as certain types of non-disclosure, confidentiality, no-recruit, and training-repayment agreements, as well as other provisions that are frequently included in severance agreements, CEO agreements, employee contracts, settlements, deferred compensation arrangements, and employee handbooks. In particular, the Proposed Rule provides as an example of a *de facto* non-compete clause a non-disclosure or confidentiality agreement "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." While the Proposed Rule would only apply to restrictions on what the worker may do after the conclusion of the worker's employment with the employer, certain "garden leave" provisions—which are functionally the equivalent of paying severance during a non-compete period even if often structured to technically apply during a period of continued employment—may potentially also be covered under the concept of *de facto* non-compete clauses.

The Proposed Rule's Scope

The Proposed Rule's breadth is evident not only in the types of agreements it prohibits, but also in the scope of employers and workers to whom it applies. In its current form, the Proposed Rule would apply to employers of all sizes, whether for-profit, non-profit, and all paid and unpaid workers,

including independent contractors, externs, interns, volunteers, or apprentices.[1] There are no exceptions based on the type of work, size of the employer, type of employer, categories of workers, the employee's title, or wage thresholds. Thus, the prohibition would apply to assistants and CEOs alike, regardless of the role they have in the organization, their level of access to the organization's proprietary information, business plans, and trade secrets or how much (if any) money they make. This is a significant departure from most state common law (and even some state statutory) regimes which often apply a "reasonableness" standard based on the facts and circumstances of the nature of a particular worker's employment and the scope (including temporal and geographical) of the non-compete clause to determine whether a non-competition restriction is enforceable. Nonetheless, the Proposed Rule expressly purports to supersede any state law that would be less protective to workers than this far-reaching ban.

Retroactive Application

Notably, the Proposed Rule would apply retroactively. Employers would be required to rescind all existing non-compete clauses by the date of compliance and individually notify all current and former workers impacted by the change within 45 days after the date of rescission. For example, any employer with a provision in its employee handbook that falls within the Proposed Rule's definition of "non-compete clause" would have to rescind that provision and promptly reach out to current employees to individually notify them that the provision was rescinded. The employer would also have to promptly notify any former employees impacted by the rescission. Although the Proposed Rule includes a notice template that employers may use to comply with their rescission obligations and a safe-harbor provision acknowledging that employers who use the form notice will be deemed to have complied, this aspect of the Proposed Rule may prove challenging to implement given the ambiguity around which agreements may be considered *de facto* non-compete clauses.

Exceptions (or Lack Thereof)

The Proposed Rule has two narrow exceptions. First, the Proposed Rule permits the use of non-compete clauses in the "sale of the business" context between the seller and buyer of a business when the restricted party is a "substantial owner"—or someone who holds at least 25% ownership—in the business entity being sold. Second, the Proposed Rule would not apply to agreements between franchisors and franchisees (although individuals who work for franchisors and franchisees would still fall within its ambit).

Alternatives

In announcing the Proposed Rule, the FTC also laid out several potential alternatives, including:

- A categorical ban on non-compete agreements for some workers (*e.g.*, those earning less than $100,000) and a rebuttable presumption of unlawfulness for other workers;
- A categorical ban on non-compete agreements for some workers (*e.g.*, those earning less than $100,000) with no changes to the law of non-compete agreements for other workers;
- A rebuttable presumption that non-compete agreements are unlawful for all workers;

[1] Thus, it appears that (outside of the limited "sale of the business" exception described later in this alert) in the situation where a company might in its shareholders agreement, LLC agreement, or partnership agreement impose a non-competition restriction on all owners of the business (in their capacity as owners) during the period they hold their ownership interests, those owners who happen to also be employees (*e.g.*, a founder & CEO) could not be subject to the non-compete under the Proposed Rule, while the other owners of the business who are simply investors and not working for the company could be subject to the non-compete.

- A rebuttable presumption that non-compete agreements are unlawful for some workers (*e.g.*, those earning less than $100,000) with no changes to the law for other workers;

Other alternatives include disclosure requirements, which would require employers to disclose to workers that they would be subject to a non-compete clause prior to making employment offers, and reporting rules, which would require employers to report certain information to the FTC relating to their use of non-compete clauses.

Key Takeaways

The Proposed Rule must clear various procedural hurdles before taking effect; however, if and when it does, employers will be required to act quickly. Employers would be required to come into compliance 180 days after the final rule is published in the *Federal Register*. Notably, the Proposed Rule would require employers to rescind existing non-compete clauses by the compliance date and notify all impacted workers within 45 days of that date.

More generally, the Proposed Rule is the latest example of the Biden Administration's commitment to using federal antitrust laws to curb the use of non-compete clauses. Indeed, the FTC issued its first enforcement actions challenging the use of non-compete clauses the day before the Proposed Rule was announced. As we've written about previously, the Department of Justice has also begun taking a more aggressive stance on labor-market agreements.

Patterson Belknap will monitor subsequent developments in connection with this Proposed Rule. For additional guidance or to discuss submitting a comment to the FTC, please contact our Employment Law Group.

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