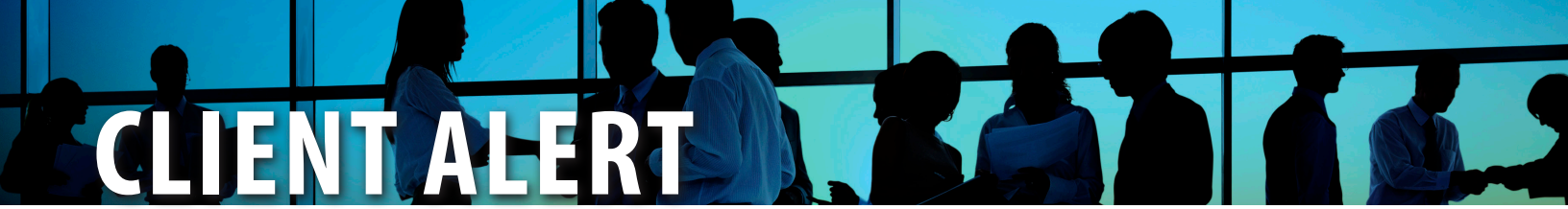

Federal Trade Commission Proposes Rule to Ban Non-Compete Clauses

by Jeffrey M. Beemer, Collin J. Kelly, Patrick J. Masterson, and L. Pahl Zinn

On January 5, 2023, the Federal Trade Commission ("FTC") issued a notice of proposed rulemaking ("NPRM") to ban the use of non-compete clauses with all workers. Although not yet enforceable, the proposed rule marks a dramatic departure from the current regulatory landscape, which is primarily dictated by state law. A non-compete clause is a contractual term that prohibits an individual from competing against the other party—either by working for or starting a competing business—for a certain period within a given geographic area. If finalized and enforced as-is, the proposed rule's categorical prohibition of non-compete clauses would set a national standard, resulting in the preemption of the vast majority of states' current regulation of non-compete clauses and abrogating decades of case law.

The Proposed Rule's Significance

As written, the proposed rule would declare non-compete clauses an unfair method of competition for an employer to enter into or attempt to enter into with a worker. The proposed rule broadly defines non-compete agreements 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."*

Generally, other restrictive covenants, such as non-disclosure agreements and non-solicitation agreements, are not prohibited under the proposed rule. While most would assume this would mean that employers could still contract with employees to ban them from soliciting clients, customers, and employees, the proposed rule deploys a functional test to determine whether a specific covenant is a non-compete clause. Meaning even non-solicitation provisions could come within the scope of the NPRM because the NPRM aims to ban any agreement that 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."*

For example, the NPRM identifies a non-disclosure agreement written so broadly to effectively preclude the worker from working in the same field after the conclusion of the worker's employment with the employer as a functional non-compete that would violate the proposed rule. The proposed rule also prohibits contractual terms between an employer and a worker that requires the worker to reimburse the employer or a third party for training costs if the worker's employment terminates within a specified time in situations where the payment is not reasonably related to the expenses the employer incurred to train the worker.

Further extending the proposed rule's scope, the ban on non-compete clauses would apply to all workers. *"Worker"* is broadly defined as *"a natural person who works, whether paid or unpaid, for an employer"* and expressly includes, without limitation, *"an employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer."* Because the ban on non-compete clauses is categorical, the proposed rule treats all workers the same, no matter the worker's salary or position within the business.

Although the scope of the proposed rule is extensive, there are two notable exceptions. First, a non-compete clause may still be used to prevent a person from selling a business, selling all of the person's ownership interest in the industry, or selling all or substantially all of the operating assets of a business from competing with the purchasers of the business. For this exception to apply, the restricted party must be an owner, member, or partner holding at least 25% ownership interest in the business entity. Second, the term "worker" does not include a franchisee in a franchisor-franchisee relationship.

If the NPRM goes into effect, it will prohibit an employer from:

(1) entering into or attempting to enter into a non-compete agreement with a worker;
(2) maintaining a non-compete agreement with a worker; or
(3) representing to a worker, under certain circumstances, that the worker is subject to a non-compete agreement.

The proposed rule would require employers that entered into a non-compete clause with workers before the rule's compliance date to rescind those non-compete clauses. Compliance with the proposed rule would also require an employer to provide written notice to its workers that the rescinded non-compete clauses are no longer in effect and may not be enforced against the workers. The proposed rule would also supersede any inconsistent state statute, regulation, or rule, unless that state statute, regulation, or rule affords workers greater protections. Thus, the proposed rule would create a national regulatory floor while allowing states to provide additional protections for workers.

The Rulemaking Process and Expected Challenges

While the substance of the proposed rule provides a dramatic departure from the current regulatory landscape, it is not yet enforceable. The NPRM is just an initial step in the rulemaking process. The FTC will soon publish the NPRM in the Federal Register, which will trigger a 60-day public comment period. The NPRM invites public comment on specific questions, including whether franchisees should be covered in the definition of *"worker"* under the rule, low-and high-wage workers should be treated differently under the rule, and whether senior executives should be exempted from the rule.

Following the notice-and-comment period, the FTC will publish a final rule. The final rule could differ from the proposed rule based on the received public comments. After the final rule's publication, employers will have 180 days to rescind current non-compete clauses and provide the required notice to workers. Upon the expiration of the 180-day compliance period, the FTC could commence enforcement.

However, the proposed rule could face delays beyond the rulemaking process. Any final rule is expected to face intensive legal challenges. These legal challenges primarily center around whether or not the FTC possesses the authority to impose such a sweeping regulation of non-compete agreements in the employment setting.

Immediate Considerations for Employers

Although the proposed rule is not yet finalized or enforceable, there are immediate actions employers can take to prepare for the changing regulatory landscape. First, concerned parties may submit vigorous comments explaining the potential costs and adverse effects of the proposed rule on their business. In encouraging stakeholders to submit a public comment, Commissioner Christine S. Wilson emphasized in her dissenting statement regarding the NPRM that "this solicitation for public comment is likely the only opportunity they will have to provide input not just on the proposed ban, but also on the proposed alternatives."

Employers also can review their existing agreements with workers to assess their exposure to the proposed rule. That review should account for all restrictive covenants, including non-disclosure agreements and nonsolicit agreements, to assess whether such covenants effectively preclude the worker from working in the same field after the conclusion of the worker's employment with the employer, therefore operating as a functional non-compete that would violate the proposed rule.

Dickinson Wright attorneys closely monitor the FTC's actions regarding its regulation of employers' dealings with their workers and are available to discuss how these regulations could impact your business. Additionally, Dickinson Wright attorneys stand ready to assist in preparing a public comment for submission on this proposed rule.

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