Updates
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FTC Announces Proposed Ban on Noncompete Agreements

The Federal Trade Commission (FTC) announced its proposal of a new rule on January 5, 2023, that would ban employers from imposing noncompete clauses on their workers and invalidate all existing noncompetes currently in effect. According to the FTC, this will affect 30 million, or one in five, American workers currently covered by a noncompete agreement.

What Is the Proposed Rule?

As written, the FTC's proposed rule prohibits employers from doing any of the following actions:

- Entering into or attempting to enter into a noncompete with a worker.
- Maintaining an existing noncompete with a worker.
- Representing to a worker that the worker is subject to a noncompete.

The proposed rule also requires employers to complete both of the following actions:

- Rescind existing noncompetes within 180 days of publication of the final rule.
- Actively notify current and former workers that the noncompete is no longer in effect, following specific notice requirements.

What Counts as a Noncompete Under the Proposed Rule?

The FTC's proposal, if finalized, would ban and invalidate any noncompete clause, 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."

On its face, the proposal does not prohibit other contractual provisions typical in the employment context, such as nonsolicitation, confidentiality, and nondisclosure agreements. However, the proposed rule contains a "functional test" for any contractual term that acts as a de facto noncompete clause (i.e., one that has the effect of prohibiting a worker from seeking or accepting employment with another employer). The FTC offers two nonexhaustive examples of a de facto clause:

1. **Nondisclosure agreements.** A nondisclosure agreement that's "written so broadly that it effectively precludes the worker from working in the same field."
2. **Training cost repayment.** Agreements to repay training costs if workers terminate their employment too soon, where the required payment isn't "reasonably related to the costs the employer incurred for training the worker."

Whom Does the Proposed Rule Affect?

The proposed rule covers nearly all workers and nearly all employers. It applies to all persons who work for an employer, whether paid or unpaid. This rule includes employees, independent contractors, externs, interns, volunteers, apprentices, and even sole proprietors who provide a service to a client or customer. "Employer" is

defined as "a person that hires or contracts with a worker to work for the person."

The proposed rule excludes a franchisee in the context of a franchisee-franchisor relationship. However, someone who works for a franchisee or franchisor is still a "worker" within the meaning of the proposed rule and would be covered.

Are There Exceptions to the Proposed Rule?

The proposed rule carves out an exception for the sale of the business. Specifically, the rule would not apply to noncompetes "entered into by a person selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity, or by a person who is selling all or substantially all of a business entity's operating assets." The exception only applies to someone with a "substantial" ownership stake, which means they hold at least a 25% ownership interest. The FTC notes that these agreements would remain subject to federal antitrust law as well as other applicable laws.

What Are the Consequences of Noncompliance?

The proposed rule does not establish a private right of action for workers. As written, only the FTC would be able to pursue rule violations. However, it is important to remember that noncompetes can still be challenged through private antitrust litigation. Under the Sherman Act, noncompetes must be narrowly tailored and further a legitimate procompetitive interest.

How Would the Proposed Rule Affect State Law?

The proposed rule would preempt any state and local law inconsistent with its provisions, but it would not preclude those that afford workers greater protection than the proposed rule. As a practical matter, the proposed rule would supersede existing noncompete requirements in most states.

When Does the Proposed Rule Go Into Effect?

The FTC is currently seeking public comment on the proposed rule, which is due 60 days after the *Federal Register* publishes the proposed rule. After the period for comment closes, the FTC will consider the comments, and then they may adopt and publish a final rule. As currently drafted, the proposed rule would go into effect 180 days after the publication of the final rule. The proposed rule could be finalized by the end of the year.

If the FTC eventually adopts a final rule, the proposal is likely to trigger legal challenges to the scope of the FTC's rulemaking authority for adopting such a rule, which may affect the timeframe for compliance.

What Should Employers Do?

Employers should prepare for the possibility of a broad ban on worker noncompetes and track this proposed rule closely.

If the rule as proposed becomes final, employers will have to comply with the rule's rescission and notification requirements. This will be no small feat. Employers will need to notify their current and former workers in an

individualized communication in writing (or digital format) that their noncompete is no longer in effect and may not be enforced. Employers will also have to review other employment agreements, such as nondisclosure agreements and other restrictive covenants, that may be implicated by the rule's functional test for compliance.

Even if the proposal is not adopted, employers should take note of the administration's trending efforts to regulate the employment relationship at the federal level. The FTC's announcement came just one day after the commission announced settlements with three companies and two individuals for allegedly illegal noncompete agreements imposed on workers—the first time the FTC has asserted that noncompetes constitute unfair competition under Section 5 of the Federal Trade Commission Act (FTCA) and has sued to halt the noncompetes. In that announcement, the deputy director of the FTC's Bureau of Competition is quoted saying, "The FTC is committed to ensuring that workers have the freedom to seek higher wages and better working conditions without unfair restrictions by employers . . . The FTC will continue to investigate, and where appropriate challenge, noncompete restrictions and other restrictive contractual terms that harm workers and competition."

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