Articles + Publications | January 6, 2023

FTC Proposes Rule to Ban Noncompete Clauses With Very Limited Exceptions

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On January 5, the Federal Trade Commission (FTC) voted 3-1 to publish its Notice of Proposed Rulemaking, proposing a new rule that, if implemented, would bar employers from entering into noncompete agreements with their workers, and require employers to rescind existing noncompete restrictions with current and former workers. The proposed rule supersedes state laws that are less protective of employees, but keeps the state law that provides employees greater protection. The proposed rule excludes franchisees from the definition of "worker" and has a single, limited exception that applies to the sale of a business.

Scope of the Proposed Rule

First, the FTC's proposed rule would effectively ban worker noncompete provisions by deeming them "unfair method of competition" under Section 5 of the FTC Act. The proposed rule would make it unlawful for employers to enter into, or keep in place, any noncompete provisions with current or former workers. Noncompete provisions are defined as contract terms that "prevent workers from seeking or accepting employment" or "operating a business" after their employment with the employer ends.

The proposed rule does not apply to customer or employee nonsolicitation provisions or generally to confidentiality or nondisclosure agreements. The proposed rule applies a functional test for determining whether a clause is covered by the rule. A provision is considered a "de facto" noncompete provision if 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." The proposed rule includes an example of a de facto noncompete term as a "nondisclosure agreement between an employer and a worker 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."

The proposed rule defines the term "worker" very broadly to include any "natural person who works, whether paid or unpaid, for the employer," including "independent contractors, externs, interns, volunteers, apprentices, or sole proprietors who provide a service to a client or customer."

Notice Obligations Imposed by the Proposed Rule

If the rule becomes effective, employers who have existing noncompete provisions that violate the rule would be required to affirmatively rescind existing noncompete clauses with current workers and give individualized notice to workers that they are no longer subject to the noncompete clause. Employers would also be required to rescind

noncompete clauses in effect with former workers, and give former workers notice of such rescission, so long as the employer has the former worker's contact information readily available. Employers would be prohibited from notifying a worker that the worker is covered by a noncompete clause when the employer has no good faith basis to believe the worker is subject to an enforceable noncompete clause.

Exception for Sale of Business

The proposed rule provides a single, limited exception related to the sale of a business. The exception provides that the rule "shall not apply to a noncompete clause that is entered into by a person who is selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity." The exception applies, however, only to a person who owns at least a 25% ownership interest in a business entity at the time that the person enters into the noncompete clause. It is unclear as to whether the proposed rule's exception applies to existing noncompete terms applied to future sales of a business, or only to noncompete terms entered into at the time of the sale.

Relation to State Laws

The proposed rule provides that it supersedes any state statute, regulation, order, or judicial interpretation that is inconsistent with the proposed rule. A state statute, regulation, order, or interpretation is not inconsistent with the proposed rule, however, if it provides greater protections to workers than the proposed rule. As a result, the proposed rule would essentially set a floor for worker protection against noncompete agreements, but also keep in effect state and federal law that provides workers greater protection.

Public Comment

The FTC seeks public comment on the proposed rule 60 days after publishing it in the Federal Register. Specifically, the FTC seeks comments on several different alternatives to this noncompete ban, such as whether noncompete clauses between employers and senior executives should be subjected to a different rule than noncompete clauses between employers and other workers. The FTC also seeks comments on the possible benefits and costs of the proposed rule, the impact of the proposed rule on businesses, and possible compliance costs should the proposed rule be implemented.

Compliance Date

The proposed rule would establish a separate effective date and compliance date. The proposed rule's effective date will be 60 days after the final rule is published in the Federal Register. The compliance date will be 180 days after the final rule is published in the Federal Register.

The time between the effective date and compliance date is the "compliance period," during which employers will need to prepare to comply with the proposed rule's provisions by the compliance date.

What Does This Mean for Employers?

Employers should carefully monitor the status of the proposed rule. It will likely face significant legal challenges,

and its fate is far from certain. Employers should consider, however, conducting an audit of their noncompete agreements and practices with respect to such agreements to determine whether, and to what extent, they may be impacted should the proposed rule become the law of the land.

For example, employers who have previously relied primarily on noncompete restrictions to prevent unfair competition or theft of trade secrets may consider strengthening or modifying their nonsolicitation and nondisclosure restrictions. Specifically, employers should evaluate their confidentiality agreements, which are often very broad, to evaluate the risk that they may be considered “de facto noncompetes” that are invalidated by the proposed rule and ensure that they comply with the antitrust laws. Employers may also consider conducting an audit to evaluate and identify vulnerabilities within their organization in the event key current and former employees suddenly have unenforceable noncompete restrictions. Having a contingency plan in place now would save resources and potentially prevent significant impacts to the bottom line.

Should the proposed rule be adopted in its current state, this will also place much greater importance on policing corporate confidential and trade secret information, as companies would lose the ability to prevent former employees from immediately working for a direct competitor. This provides additional incentive for companies to proactively take stock of their confidentiality practices and agreements to ensure they are fully prepared in the event the proposed rule is implemented in its current form by the FTC.

If you have any questions, comments, or concerns about the proposed rule and its implications, Troutman Pepper’s Labor + Employment and Antitrust attorneys are available to guide you through these issues and evaluate the best strategy for your business.

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