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ALERT

FTC Proposes New Rule to Broadly Ban Non-Compete Agreements

January 6, 2023

Overview

On January 5, 2023, the Federal Trade Commission (FTC or Commission) released a Notice of Proposed Rulemaking (NPRM) that seeks to ban employers from imposing or enforcing non-compete clauses on workers. The FTC's proposed rule would functionally serve as a complete ban on non-compete clauses and contractual provisions or employment policies that have a similar effect. The NPRM invites stakeholders to comment and provide input on the proposed ban and potential alternatives. The notice and comment period will end 60 days from when the NPRM is published in the Federal Register. The FTC has been signaling a crackdown on non-compete clauses, especially after the Biden Administration encouraged the FTC to adopt such a ban, and several states and territories have enacted bans or prohibitions on the use of non-competes for workers who earn less than a statutory threshold – e.g., California, Washington, D.C., North Dakota, Oklahoma, Illinois, Maryland, Virginia, and Washington.

Restrictions and Requirements

The proposed rule prohibits 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 that they are subject to a non-compete without a good faith basis to believe that the worker is subject to an enforceable non-compete.

Authors

Megan L. Brown
Partner
202.719.7579
mbrown@wiley.law

Olaoluwaposi O. Oshinowo
Of Counsel
202.719.4275
ooshinowo@wiley.law

Duane C. Pozza
Partner
202.719.4533
dpozza@wiley.law

Kathleen E. Scott
Partner
202.719.7577
kscott@wiley.law

Kahlil H. Epps
Associate
202.719.4661
kepps@wiley.law

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The proposed non-compete ban would have retroactive effects that apply to agreements entered into before the final rule's effective date, and the rule requires employers that maintain non-competes with their workers to rescind those agreements no later than the compliance date (180 days after the final rule is published in the Federal Register). That recision process requires employers to provide current and former workers with an individualized paper or digital communication within 45 days of rescinding the non-compete agreement, which must contain language explaining that "the worker's non-compete clause is no longer in effect and may not be enforced against the worker."

The lone exception to the proposed rule applies to individuals selling a business entity, ownership interest in a business entity, or all of a business entity's operating assets where the individual restricted by a non-compete was a substantial owner, member, or partner in the business entity as they agreed to the non-compete.

Notably, the proposed rule would apply the ban on the maintenance or enforcement of non-compete agreements to employees, independent contractors, and any other category of worker, whether paid or unpaid.

Administration, Enforcement, and Penalties

The final rule would be administered and enforced by the Federal Trade Commission. Complainants may file a complaint or request for Commission action via the Commission's web-based complaint site or by a signed statement filed with the Office of Secretary.[1]

Key Issues and Considerations

The proposed rule defines a non-compete clause as an agreement that prevents a worker from seeking or accepting future employment or opening their own business after ending their employment with their employer and makes clear that the ban would also apply to contractual provisions or policies that are *de facto* non-compete clauses. The proposed rule explains that a *de facto* non-compete clause is a contractual provision that has the effect of prohibiting a worker from seeking or accepting employment with another employer and provides two examples:

> (1) a non-disclosure agreement written in such a way that effectively precludes a worker from working in the same field after ending employment with an employer; and (2) a contractual term that requires a worker to pay the employer for training cost if the worker's employment is terminated within a specified period.

The FTC voted 3-1 to publish the NPRM, which is likely the public's only chance to comment on the proposed rule. The lone dissenting vote, Commissioner Christine S. Wilson, issued a statement outlining three potential legal challenges the final rule could face if issued: (1) the Commission lacks authority under the FTC Act to engage in "unfair methods of competition" rulemaking; (2) the Commission's authority to promulgate the non-compete clause rule is susceptible to challenge under the major questions doctrine; and (3) if the Commission does possess such authority, it could be an impermissible delegation of legislative authority. Those three issues are likely to be a road map for objections and comments from stakeholders. Additionally, the FTC will

need to base any final rule on a sufficient evidentiary record.

Next Steps for Employers and Associations

The FTC will begin accepting comments on the proposed rule after the NPRM has been published in the Federal Register.

Employers and Associations should contact counsel if they wish to submit a comment during the notice and comment period to help facilitate an appropriate response to the proposed rule.

There is a chance that the non-compete clause ban will not survive the implementation process due to either public comments or potential legal challenges, but that is far from certain at this stage. Employers and Associations should take steps to identify and review existing policies, procedures, and agreements that may be impacted if the proposed rule becomes final and to explore the development of policies and agreements that protect confidential and proprietary information and other legitimate business interests without acting as a *de facto* non-compete agreement.

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1 *See* 16 C.F.R. §0.1 (2021); 16 C.F.R. §2.1 (2000); 16 C.F.R. §2.2 (2012).