January 8, 2023

FTC Proposes Rule to Ban Employer-Worker Non-Compete Clauses

- On January 5, 2023, the Federal Trade Commission (FTC) proposed a rule that would impose a blanket ban on existing and new employer-worker non-compete agreements by classifying them as "unfair methods of competition."
- The proposed rule also would require employers to rescind existing non-compete agreements and actively inform former workers subject to such agreements that they are no longer in effect. According to the FTC's estimation, this would impact as many as one in five American workers, approximately 30 million people, and their employers.
- The proposed rule is subject to a 60-day comment period before it becomes final, and comments can be expected from a wide range of interested parties. The inquiry into the costs and benefits of non-compete agreements has been the subject of considerable debate among both legal and economic scholars, and this debate will likely be central to the views expressed during the comment period. There will likely be legal challenges to the FTC's authority to promulgate the rule, which may delay or ultimately prevent the implementation of the rule.
- If finalized, the rule would displace many less restrictive state laws and result in a fundamental change in federal antitrust law that for decades has required a fact-specific analysis into the effects of non-compete agreements. This would result in a significant shift for many employers.

Background

Employer-worker non-compete agreements have generally been governed by state law and subject to only occasional challenges under federal antitrust law. But the Biden Administration has more recently prioritized the use of federal antitrust law to bring broad challenges to non-compete agreements and related limitations in employment agreements. In July 2021, President Biden encouraged the FTC "to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility" through rulemaking. In October 2021, the Acting Assistant Attorney General of the Antitrust Division stated that the Antitrust Division was "committed to using its civil authority to detect, investigate, and challenge anticompetitive non-compete agreements." In December 2021, the FTC and DOJ held a workshop on "Promoting Competition in Labor Markets," where non-compete agreements were discussed. And in February 2022, DOJ asserted in a court filing that certain categories of employer-employee non-compete agreements may be considered per se illegal horizontal agreements among competitors.

The FTC contends that one in five American workers, approximately 30 million people, are bound by non-compete clauses, and are thus prevented from leaving jobs to pursue better employment opportunities. The FTC also states that non-compete clauses prevent new businesses from forming and from innovating. The FTC estimates that the proposed rule would increase American workers' earnings between $250 billion and $296 billion per year.

On January 4, 2023, the FTC voted 3-1 to resolve through consent orders challenges to the use of non-compete agreements by three companies and two individuals, requiring them to remove non-compete restrictions imposed on thousands of workers on the ground that they constitute "an unfair method of competition under Section 5 of the FTC Act." The challenges involved non-compete provisions in contracts with security guards, engineers, and manufacturing workers. The FTC will publish the consent

agreement packages in the Federal Register, allow the public to submit comments within a 30-day period, and determine whether to finalize the proposed consent orders. The FTC noted that these consent orders "mark the first time that the agency has sued to halt unlawful noncompete restrictions" outside of the merger context.

The FTC's Proposed Rule

On January 5, 2023, the FTC issued a Notice of Proposed Rulemaking regarding non-compete clauses, including the proposed rule and a fact sheet. The proposed rule states that it is an "unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or represent to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause."

The proposed rule contains a broad definition of a "non-compete clause"—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." According to the proposed rule, this would include a non-disclosure 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" and a "contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker."

The proposed rule defines "worker" to include "an employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer." The proposed rule does not distinguish between categories of employees. The definition excludes "a franchisee in the context of a franchisee-franchisor relationship," though individuals who work for a franchisee or franchisor are included in the definition of "worker." The rule notes that "non-compete clauses between franchisors and franchisees would remain subject to Federal antitrust law as well as all other applicable law."

The characterization of employer-worker non-compete agreements as "unfair methods of competition" is significant because unfair methods are unlawful under Section 5 of the FTC Act,[1] which the FTC majority maintains prohibits a broader set of conduct than the antitrust laws. In November 2022, the FTC issued a policy statement significantly expanding its interpretation of conduct that constitutes unfair methods of competition under the FTC Act.

If the FTC has "reason to believe" that an entity "has been or is using" an unfair method of competition, it may bring an administrative complaint for a cease and desist order. Such an order is reviewable by a court of appeals. Violations of orders are subject to a civil penalty. Section 5 does *not* create a private right of action. The proposed rule requires employers to rescind existing non-compete clauses and provide notice of the recission to their workers.

The proposed rule includes a limited exception from the ban on employer-worker non-compete agreements in the sale-of-business context for a "substantial owner of, or substantial member or substantial partner in," a business entity that is being sold, defined in the proposed rule as "an owner, member, or partner holding at least a 25 percent ownership interest in a business entity" at the time the person enters into the non-compete clause. This exception would not apply to individuals selling or disposing of their ownership interests in an asset if they otherwise would be considered a significant owner but do not hold a 25 percent ownership interest in the business entity sold. As drafted, the proposed rule may not ban pure sale-of-business non-compete clauses where an individual selling or disposing of an ownership interest (in any amount) does not become employed by the buyer. The FTC notes that such clauses "would remain subject to Federal antitrust law as well as other applicable law." In recent years, the federal antitrust agencies have taken action against non-compete clauses in business sales that are, according to the agencies, overly broad in time or geographic scope. For example, in August 2022, the FTC approved a final order to limit a

[1] Federal Trade Commission Act, 15 U.S.C. §§ 41-58.

non-compete agreement imposed by two gasoline and diesel companies against another company, because the agreement was "unreasonably overbroad in geographic scope and longer than reasonably necessary to protect a legitimate business interest."

FTC Rulemaking Authority

Any final rule is likely to generate legal challenges to the FTC's rulemaking authority. The FTC relies on section 6(g) of the FTC Act, which provides that the FTC has power "to make rules and regulations for the purpose of carrying out the provisions" of the FTC Act. However, whether the FTC has authority to issue rules regarding unfair methods of competition under the FTC Act is heavily contested. The only precedent on the issue is a decision by the D.C. Circuit in 1973,[2] but the Supreme Court has not addressed the issue, and many administrative law scholars are skeptical that today's Supreme Court would agree that the FTC has authority here.

Commissioner Christine S. Wilson dissented from the FTC's 3-1 vote to issue the proposed rule. Commissioner Wilson's dissenting statement stated that the FTC's rulemaking authority "certainly will be challenged" and that the proposed rule is vulnerable to "meritorious challenges" on three separate grounds. First, the FTC may lack authority to engage in "unfair methods of competition" rulemaking, as discussed above. Second, under the major questions doctrine, which requires Congress to speak clearly when authorizing agency action on an issue of national significance, the FTC may lack clear Congressional authorization to undertake this rulemaking. The major questions doctrine is likely to be a significant obstacle if the FTC promulgates a final rule as broad as the proposed rule; the Supreme Court recently applied this doctrine in *West Virginia* v. *EPA*[3] in finding that the EPA lacks authority to regulate greenhouse gas emissions. Finally, even assuming the FTC does possess the requisite level of authority to engage in this type of rulemaking, it still may be deemed to be an impermissible delegation of legislative authority under the non-delegation doctrine, because the FTC could be viewed as effectively replacing the consumer welfare standard, which is a fact-specific inquiry, with a categorical ban on non-compete agreements. Such a ban may be viewed as inconsistent with the approach that the Supreme Court has long taken with respect to declaring certain types of agreements to be per se illegal under the Sherman Act. Furthermore, there has long been an active and significant debate in legal and economic circles regarding the potential efficiencies of non-compete provisions. In all, Commissioner Wilson warned that the proposed rule would lead to "protracted litigation" and the FTC "is unlikely to prevail" in any legal challenge.

Next Steps - Comment Period

This proposal does not promulgate an effective rule, but merely starts the public comment process. As FTC Chair Lina Khan said in her statement, "This proposal is the first step in the FTC's rulemaking process" and "just the first step toward a final rule." Members of the public may submit comments on the proposed rule within 60 days after the proposed rule is published in the Federal Register, which usually occurs shortly after the Notice of Proposed Rulemaking is published. Comments can likely be expected from a broad range of interested parties, including companies in industries that commonly rely on non-compete agreements to protect disclosure of valuable proprietary and competitively sensitive information. After the comment period ends, the FTC will review any comments, and may revise the proposed rule and issue a final rule.

In addition to the text of the proposed rule, the FTC invites comments on several alternative proposals for regulating employer-worker non-compete agreements. First, the FTC could issue a rule creating a rebuttable presumption of unlawfulness of such restrictions, rather than a categorical ban. Second, the FTC's rule could differentiate categories of workers based on a salary threshold or another basis such as title, job function, or Fair Labor Standards Act status. Furthermore, the FTC seeks comment on, among other things, whether senior executives should be treated differently under or exempted altogether from the potential rule. Notably, the FTC acknowledged that some of its preliminary findings supporting the proposed rule do not apply to senior executives. For example, the FTC determined that non-compete agreements for senior executives are unlikely to be exploitative and coercive at the time of the executives' departure, including because senior executives are likely to have the

[2] Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya Regarding the Notice of Proposed Rulemaking to Restrict Employers' Use of Noncompete Clauses, Commission File No. P201200 (Jan. 5, 2023); *Nat'l Petroleum Refiners Ass'n* v. *FTC*, 482 F.2d 672, 683 (D.C. Cir. 1973).

[3] *W. Virginia* v. *Env't Prot. Agency*, 142 S. Ct. 2587 (2022).

assistance of expert counsel in negotiations. Commissioner Wilson encouraged stakeholders to submit comprehensive comments, noting that the public comment period is likely the "only opportunity . . . to provide input" on both the proposed ban and alternatives.

If finalized in its current form, the proposed rule would upend existing state law standards for enforcement of employer-worker non-compete agreements and may be inconsistent with protecting confidential proprietary information. We will continue to monitor developments and potential alternatives for companies to maintain the integrity of confidential information, including through garden leave or forfeiture provisions.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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