BROOKS PIERCE

No More Non-Competes? Impact of FTC's Proposed Rule

01.06.2023

Non-compete agreements have had a target on their back for some time, with several state laws already on the books to prohibit or significantly limit their use. (See laws in California, Colorado, Illinois, Maine, Maryland, New Hampshire, Oklahoma, Rhode Island, Virginia and Washington.) In the last few days, it was the federal government rather than the states taking aim.

On January 4, 2023, the Federal Trade Commission (FTC) found that the non-compete agreements of three employers "constituted an unfair method of competition" and violated the FTC Act. The FTC prohibited those employers from imposing or enforcing non-compete agreements on their workers and ordered that they provide a copy of the FTC's determination to all current and former employees who were covered by the non-compete agreements.

The next day, the FTC issued a proposed rule prohibiting non-competes for all employers, signaling that the age of non-competes in the employment context may be coming to an end. In issuing its proposed rule, the FTC has taken the position that the harms inflicted on workers and competition by non-competes—suppressing workers' wages by preventing them from moving freely between employers, exploiting workers' lack of bargaining power in negotiating employment agreements, stifling innovation by preventing people from forming new businesses—outweigh employers' interests in protecting their investments and trade secrets through non-compete provisions.

The proposed rule defines a non-compete clause 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," and includes de facto non-compete clauses that prohibit a worker from seeking or accepting employment under a functional test.

The proposed rule then forbids employers from entering into, attempting to enter into, maintaining, or representing to a worker that they are subject to a prohibited non-compete clause. It also requires employers to rescind existing non-competes and individually notify current workers and former workers (if contact information is available), in writing, that the non-compete is no longer in effect and is unenforceable against the worker.

Notably, the FTC does recognize that non-competes still have their place, just not in the employment context. Specifically, the proposed rule excludes non-competes entered into by someone who is selling a business entity, selling substantially all of their ownership interest in the

business, or selling substantially all of the business's assets (although antitrust law and other applicable restrictions would still apply). This exception applies to someone who is a substantial owner of, or a substantial member of or partner in, the business entity.

This does not mean that the FTC left employers entirely without the ability to protect their investments. Indeed, background information provided with the proposed rule clarifies that other contractual provisions or restrictive covenants would not be impacted by the proposed rule, so long as those covenants are not so broad that they function as *de facto* non-competes. Examples of restrictive covenants that may be excluded from the non-compete ban include:

- non-disclosure agreements (a.k.a. confidentiality agreements),
- client or customer non-solicitation agreements (i.e., those that prevent a worker from soliciting customers of their former employer),
- no-recruit agreements (i.e., those that prevent the worker from recruiting or hiring their former employer's other workers), and
- no-business agreements (i.e., those preventing a worker from doing business with former customers of their previous employer).

However, employers should proceed with caution when reviewing existing restrictive covenants or drafting new agreements containing these types of provisions. Employers will need to ensure that the language used in other restrictive covenants is carefully drafted and narrow enough to avoid becoming a *de facto* non-compete.

Of course, the proposed rule is not final. It is open to public comment for 60 days after the *Federal Register* publishes the proposed rule. The FTC would expect employer compliance with the rule within 180 days after publication of the final rule. Court battles and legal challenges to the FTC's authority to impose and enforce such a rule are also likely. Nevertheless, the message is strong. The tide is turning against non-competes, and even without the new rule, the FTC is cracking down on them as an unfair method of competition.

The text of the proposed rule can be accessed here.

This Alert provides an update on a legal development. It is not intended as legal advice. For assistance evaluating how this proposed rule may impact your workplace, please reach out to a member of the Brooks Pierce Labor & Employment team.

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