New FTC Rule Bans Noncompetes, but Franchise Relationships Exempted

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On April 23, 2024, the Federal Trade Commission ("FTC") announced a new rule banning enforcement of noncompete agreements between for-profit employers and employees. The rule specifically mentions the relationship between franchisors and franchisees but excludes application to the franchisor-franchisee relationship.

The FTC Rule

The FTC found noncompete agreements to be an unfair method of competition and therefore in violation of Section 5 of the FTC Act. The new rule is based on the premise that noncompete agreements can stifle economic activity, suppress wages, or contribute to higher consumer prices. Notably, this new rule would make the vast majority of employee noncompete agreements unenforceable. The rule is slated to take effect 120 days after publication in the Federal Register, at which point suspected violations of the rule can be reported to the Bureau of Competition.

There are a variety of administrative and constitutional legal doctrines that could block the rule's enforcement. The U.S. Chamber of Commerce and other groups have already filed lawsuits challenging the rule, seeking injunctive relief to delay the effective date as well as a ruling to vacate the rule in its entirety. Haynes Boone is following these disputes.

Impact on Franchising – Limited, For Now

While franchisors would be affected by the rule, they probably do not need to fear a rush of competition from former franchisees. The rule prohibits noncompete agreements applicable to workers. The definition of "worker" clarifies: "The term worker includes a natural person who works for a franchisee or franchisor, but does not include a franchisee in the context of a franchisee-franchisor relationship." Thus, the rule specifically excludes the franchisor-franchisee relationship, but franchisors and franchisees are still covered to the extent that they have employees. In other words, under this rule, a franchisor can still include noncompete clauses in its franchise agreements.

The FTC previously solicited commentary on whether the rule should extend to noncompete agreements in franchise relationships but ultimately reasoned that franchisees were not "workers" because the franchisor-franchisee relationship is typically business-to-business. This comports with caselaw nationwide, which tends to find no employment relationship between franchisors and franchisees.

Despite this exclusion, the new rule necessitates caution because franchisees and former franchisees wishing to compete may claim the exclusion does not apply to them, which could complicate disputes. Additionally, as employers, franchise parties should take note of the new rule.

Looking Forward

While the current rule should not impact the franchise relationship, there were multiple public comments suggesting the rule should be extended to the franchise relationship. The commentators argued that disparity in bargaining power and investment of substantial personal assets into franchises means the franchisor-franchisee relationship is akin to the employer-employee relationship. The written explanation of the rule indicates the FTC considered these arguments thoughtfully before rejecting them. That said, the prior consideration highlights the possibility that the FTC may at some point consider a rule banning noncompete agreements within the franchise relationship.

While noncompete clauses in franchise agreements are likely safe for now under federal law, other tools such as nondisclosure agreements and trade secrets law enforcement mechanisms remain robust ways to protect a system against competition from business partners in the event of future rulemaking. Haynes Boone will continue to monitor the FTC's actions for any proposed rules that might impact franchising.