New Year, New Ban: FTC Proposes Ban of Post-Employment Non-Competes

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On January 5, 2023, the Federal Trade Commission (FTC) celebrated the New Year by proposing a new rule that, if adopted, would ban non-compete provisions regularly found in employment agreements and require recission of existing non-compete agreements, signaling a potential end to a common employment practice nationwide.

In his July 9, 2021 Executive Order, President Biden instructed federal authorities to curtail the "unfair" use of non-compete clauses and other clauses or agreements that "may unfairly limit worker mobility." The FTC's proposed rule is the agency's response to the President's directive.

In promoting the proposed rule, the FTC argues that non-compete agreements constitute an unfair method of competition and prevent workers from exercising their economic liberty by restricting their ability to freely switch jobs. The FTC believes that a nationwide ban on post-employment non-compete agreements will result in a nearly $300 billion per year increase in employee wages and better career opportunities for roughly 30 million Americans.

Non-Compete Agreements

Post-employment non-compete agreements are designed to restrict an employee's ability to compete with their former employer for a certain period of time following their separation from employment. Non-compete clauses are typically used to protect employers who expend significant resources in training and developing employees and sharing their trade secrets. Proponents of non-compete agreements maintain that they are necessary to protect business interests from unfair competition, while opponents generally argue that they systematically depress wages, inhibit innovation, and stifle competition between businesses for skilled labor.

Under current law, restrictions on non-compete agreements have been left to the states, and roughly half limit the application or enforceability of non-compete agreements between employers and employees. Some states, like California, generally ban all post-employment non-competition agreements, while others significantly constrain the use through reasonable limits on the scope of work, time, and geographic area applicable to the non-compete. Recently, a common trend has emerged among states like Oregon, Colorado, Illinois, Maryland, Virginia, and Washington, which allow for non-compete agreements, but restrict the ability of employers to implement non-compete agreements for lower-wage employees.

The FTC's proposed rule seeks to supersede the differences among state law and implement a nationwide standard for the applicability of post-employment non-compete agreements.

The Rule Itself

If adopted, the proposed rule, which is subject to public comment, will become effective 180 days after publication of the final rule. The proposed rule defines "employment" to include any work of

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any kind for an employer and broadly defines "worker" as any natural person who works, whether paid or unpaid, for an employer, including employees, independent contractors (both individuals and sole proprietors, apparently irrespective of the contractor's corporate form), interns, and volunteers.

The proposed rule bars not only traditional non-compete clauses, but any post-employment 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, *de facto* non-compete clauses can include (i) a non-disclosure agreement "that is written so broadly that it effectively precludes the worker from working in the same field": and (ii) a training repayment agreement. Based on the broad functional *de facto* standard and the government's goal of eliminating any agreements that restrict mobility, we anticipate that the FTC will try to enforce the rule against other restrictive covenants, including customer non-solicitation clauses, and clawback agreements that tie competition to loss of stock or some other benefit.

Importantly, if adopted, the proposed rule will require employers to rescind existing post-employment non-compete clauses and provide notice to all affected workers within 45 days of such recission. Employers should note that the notice requirement specifies that employers must provide this notice to both ***current and former employees***.

Mirroring many state laws, the proposed rule also establishes a limited exception to the ban on post-employment non-compete agreements when such agreements are entered into in conjunction with the sale of a business entity, a person's ownership interest in a business entity, or the assets of a business entity provided that the seller is a "substantial" (defined as holding at least a 25 percent ownership interest) owner, member or partner in the business. However, of notable concern, to the extent an owner of a business is also a "worker," and discontinues working for the business, the proposed rule could be read to prohibit any enforcement of any non-compete clause embedded in the company documents if they continue to hold their ownership position.

Finally, the proposed rule states that it will supersede any state statute or regulation governing non-compete agreements.

What's Next?

The proposed rule is not final and the language may change through the rule-making process. We also anticipate almost immediate legal challenges once a final rule is published. Still, employers should prepare for possible implementation of the proposed rule and a recission notice by creating a database of existing non-compete agreements among their current *and former* employees. Employers should also develop a plan on how they will notify all affected employees in compliance with the FTC's notice requirement.

Haynes Boone will continue monitoring the public comment process and any final rule released by the FTC. For further information, contact your Haynes Boone attorney about the proposed rule's impact on your business.

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