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# Alert | Labor & Employment

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# Federal Trade Commission Seeks Industry Comment On Proposed Noncompete Ban

**Go-To Guide:**

- FTC proposed rule would ban all noncompete clauses in the employment context except certain ones which arise out of the sale of a business
- Broad scope of the proposed rule would require employers to rescind existing noncompete agreements with workers
- Proposed rule may implicate existing nondisclosure agreements
- FTC is considering alternatives
- FTC calls for industry comments, due March 10, 2023

On Jan. 5, 2023, the Federal Trade Commission (FTC) took a significant step towards banning noncompete agreements between companies and workers. The FTC proposed a broad rule that would effectively ban all noncompete clauses entered into in the employment context. It would also require companies to rescind existing noncompete agreements. The scope of the rule could also implicate other restrictive covenants, like nondisclosure and nonsolicitation agreements.

Notably, however, the FTC called for industry comment on the proposed rule. The Notice of Proposed Rulemaking (NPRM) offered several alternative rules that the FTC is considering, along with potential justifications for those alternatives. Comments are due by March 10, 2023.

## The Proposed Rule

The proposed rule would provide that it is an unfair method of competition to:

(a) enter into or attempt to enter into a noncompete clause with a worker;

(b) maintain a noncompete clause with a worker; or

(c) represent to a worker that the worker is subject to a noncompete clause where the employer has no good-faith basis to believe the worker is subject to an enforceable noncompete clause.[1]

The proposed rule defines "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."[2] The definition expressly includes a broad clause that "*has the effect* of prohibiting 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" under a so-called "functional test."

"Worker" is broadly defined. It includes paid and unpaid individuals who work for an employer, including individuals "classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer."[3]

The proposed rule provides two examples of "de facto" noncompetes under the "functional test": (1) a non-disclosure agreement "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 (2) a contractual term requiring the worker to repay training costs where such payment "is not reasonably related to the costs the employer incurred for training the worker."

The proposed rule includes only a single exception, for a noncompete clause entered into in the context of a sale of a business provided the clause applies to an individual who owned more than 25% of the business being sold.[4]

The proposed rule would apply retroactively and provides that it is an unfair method of competition for an employer to "maintain" an existing noncompete agreement or represent to a worker that the worker is subject to a noncompete clause. To comply with that restriction, the proposed rule would require employers to "rescind the non-compete clause no later than the compliance date" and provide "individualized communication" to the affected worker regarding the rescission.[5]

The proposed rule provides that it "shall supersede any State statute, regulation, order, or interpretation to the extent that such statute, regulation, order, or interpretation is inconsistent" with the proposed

[1] Non-Compete Clause Rule, § 910.2(a).
[2] *Id.* § 910.1(b)(1).
[3] *Id.* § 910.2
[4] *Id.* § 910.3.
[5] *Id.* § 901.2.

rule.[6] Any State statute, regulation, order, or interpretation offering greater protection to the worker would not, however, be superseded.

## The FTC's Call For Industry Comments

The FTC's publication of the proposed rule triggers a 60-day public comment period. Any individual or business may submit comments on the proposed rule, which the FTC may consider in promulgating a final rule. Chair Khan's Statement accompanying the Notice of Proposed Rulemaking said that "[r]eceiving input from a broad set of market participants, including those who have experienced firsthand the effects of noncompete clauses, will be critical to our efforts." She listed three "topics . . . especially worthy of close consideration":

1) "[S]hould the rule apply different standards to noncompetes that cover senior executives or other highly paid workers?" Chair Khan's Statement said she is "keen for input on this question." Specifically, the Statement asks how such a distinction would be drawn and what standard might apply to determine the circumstances under which noncompete clauses for certain individuals would be considered an unfair method of competition.

2) "[S]hould the rule cover noncompetes between franchisors and franchisees?" Chair Khan's statement suggested that some of the same considerations could be at play in such agreements and asked for "data or other evidence that could inform our consideration of this issue."

3) "[W]hat tools other than noncompetes might employers use to protect valuable investments, and how sufficient are these alternatives?" The Statement noted in particular the role of trade secret law and confidentiality agreements as examples of other tools employers can use to protect confidential information. The Statement says that the FTC has preliminarily found that those laws are adequate to address protection of employers' investments.

Commissioner Christine S. Wilson penned a dissent that also invited public comment "on many issues." She emphasized this may be the only opportunity for public input prior to the issuance of the final rule. Several of the topics listed in Commissioner Wilson's dissent were technical in nature, focused on the limited evidence cited in the NPRM and asking for submissions of additional evidence on certain topics. Commissioner Wilson also asked for comments on the benefits and drawbacks of the alternative rules proposed in the NPRM.

Besides the potential for modification of the proposed rule, the proposed rule—whether adopted as proposed or with modifications—is likely to face robust and prolonged legal challenges. Commissioner Wilson, dissenting, wrote that the "proposed rule will lead to protracted litigation in which the Commission is unlikely to prevail."

## Potential Alternatives Under FTC Consideration

Section VI of the NPRM highlights two potential alternatives to the FTC's proposed rule. First, the NPRM suggests the FTC could impose a "rebuttable presumption of unlawfulness instead of a categorical ban." If the FTC were to take this approach, noncompete agreements would be presumptively unlawful, but an employer would be permitted to show that the clause should be enforceable under particular circumstances. The NPRM notes that such an approach would be similar to most existing state law where noncompete agreements are "disfavored" but permissible when used to protect "legitimate business

[6] *Id.* § 910.4.

interests" like confidential information or goodwill. However, the NPRM says that if the FTC were to ultimately adopt the rebuttable presumption approach, its rule would be more restrictive than current law.

Second, the NPRM suggests that rather than a categorical ban, the FTC "could apply different rules to different categories of workers." Under that approach, the FTC could promulgate a rule with a categorical ban for some workers (e.g., low-paid workers) but impose a rebuttable presumption of unlawfulness for others (e.g., "highly paid, highly skilled workers such as executives"). The NPRM notes that there is no accepted definition for "executives" under federal law, but points to U.S. Securities and Exchange Commission reporting requirements as a potential source for such a definition.

### Immediate Considerations for Employers

The proposed rule faces an uncertain future, but employers should promptly consider three steps:

- Consider providing comments to the FTC, either individually or through an industry group. The NPRM and statements by both Chair Khan and Commissioner Wilson call for robust comments from the public on various specific issues. Well-informed comments from industry participants may influence the scope of a final rule.
- Assess other forms of restrictive covenant provisions and trade secret/confidentiality protections. The proposed rule does not directly restrict the use of well-drafted non-solicitation or nondisclosure agreements. If a ban on non-competition clauses ultimately goes into effect in any form, then other post-employment restrictive covenants will be more important than ever. However, employers should consider whether existing restrictive covenants could be considered "de facto" non-competition clauses under the proposed rule and consider making proactive changes to those standard agreements.
- Consider proactively adopting customized noncompete agreements for certain segments of the workforce. The NPRM says the FTC is considering applying different standards for different categories of employees. Ensure any noncompete provision complies with existing state law.

## Authors

This GT Alert was prepared by:


- Gregory S. Bombard | +1 617.310.6027 | Gregory.Bombard@gtlaw.com
- Justin K. Victor | +1 678.553.2169 | victorj@gtlaw.com
- Jacob R. Dean | +1 678.553.2161 | deanj@gtlaw.com