

FTC Seeks to Ban Non-compete Clauses: What This Really Means for Your Business

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Today we will cover how the FTC seeks to ban non-compete clauses and what this means for your business. On January 5, 2023, the Federal Trade Commission ("FTC") proposed a new rule banning employers from imposing non-competes on their workers. The rule is undoubtedly politically motivated as it was issued in response to President Biden's Executive Order that encouraged the FTC to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."

The FTC believes a non-compete is a "widespread and often exploitative practice that suppresses wages, hampers innovation, and blocks entrepreneurs from starting new businesses." By stopping this practice, the FTC erroneously estimates wages would increase by nearly \$300 billion per year, and it would expand career opportunities for 30 million Americans.

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Scope of Proposed Rule to Ban Non-compete Clauses

The FTC's proposed rule would prohibit employers from using non-compete clauses – i.e., any contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, within a specific geographic area and period of time after the conclusion of the worker's employment with the employer. It would make it illegal for an employer to:

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 1. enter into or attempt to enter into a non-compete with a worker;
 2. maintain a non-compete with a worker; or
 3. represent to a worker, under certain circumstances, that the worker is subject to a non-compete.

The proposed rule would apply to "workers," broadly defined by the FTC to include employees, individuals classified as independent contractors, externs, interns, volunteers, apprentices, and sole proprietors who provide a service to a client or customer. The rule also includes a "functional test" for determining what constitutes a "de facto" non-compete clause that has the same effect as an express non-compete clause – the same test employed by courts in states that already have express prohibitions on non-compete clauses.

Effective Date of Proposed Rule

Importantly, this is a **proposed rule that is not in effect**. The proposed rule is in a comment period until March 20, 2023. We do not believe it will go into effect, if at all, until after a lengthy court battle ending with a ruling from the United State Supreme Court. Then, even if the proposed ban becomes law, employers will have 180 days to revise their agreements to conform with the law. Moreover, there are a variety of tools, such as reasonably tailored non-disclosure agreements and confidentiality provisions, employers can use to accomplish their goals without violating the proposed ban.

The proposed rule is the first step in a long process that will take years to complete. We expect the FTC will receive thousands or hundreds of thousands of comments to consider. Based on the comments, the rule will be revised. It could take the FTC until late 2023 or even the end of 2024 to issue a final rule. After the final rule is set forth, it will be subject to a legal challenge (or challenges); this will undoubtedly delay the effective date into 2025 or later, assuming the final rule survives any legal hurdles it faces. During this challenging period, a presidential election will occur, and the political winds will likely change, potentially further reversing the course of the FTC.

Criticism of the Proposed Rule

The U.S. Chamber of Commerce has opined that the FTC lacks the authority to issue the rule and ignores the benefits of non-compete. A senior vice president for the U.S. Chamber of Commerce has stated:

“Attempting to ban non-compete clauses in all employment circumstances overturns well-established state laws which had long governed their use and ignores the fact that, when appropriately used, non-compete agreements are an important tool in fostering innovation and preserving competition.”

An FTC Commissioner issued a dissenting statement when the proposed ban was announced. The dissenting statement outlined potential legal challenges noting the FTC lacks the legal authority to issue the ban, and the rule is barred by a recent United Supreme Court decision. Even if the FTC has authority, it is an impermissible delegation of that authority. The proposed rule must overcome extensive case law upholding the use of non-compete clauses that are determined to be reasonable unless they are unreasonable as to time or geographic scope.

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Exemptions to Proposed Rule to Ban Non-compete Clauses

The proposed rule would exempt non-compete agreements that a person entered in connection with the sale of a business, but only if that person owned 25% or more of that business. The FTC is also seeking comments as to whether:

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 1. non-compete clauses between employers and senior executives should be subject to a different standard;
 2. the rule should apply uniformly to all workers; and
 3. the rule should impose a categorical ban on non-compete clauses.

Alternatives to Non-compete Clauses

Employers are not without options. The FTC’s proposed rule’s definition of a non-compete clause does not include other types of covenants. Accordingly, employers should begin analyzing their confidentiality clauses, non-solicitation, and non-disclosure provisions. Carefully drafted provisions can ensure that employers are able to protect confidential information and customer relationships, as well as the poaching of current employees by former employees. Employers should also use this as an opportunity to strengthen trade secret protection plans.

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What Should I Do as an Employer?

There is no need to panic. The proposed rule will not go into law in its final form, if at all. However, now is the time to implement proper planning techniques into agreements with employees. As noted previously, with proper legal counsel, non-compete, non-solicitation (vertically and horizontally), confidentiality, non-disclosure, and other restrictive covenants can be used to accomplish the goals of employers, most of which are not within the scope of the current version of the proposed rule.

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Conclusion

Thank you for reading our blog on how the FTC seeks to ban non-compete clauses and what this means for your business. Please contact us immediately so that we can assist you in your planning and contract drafting process to properly implement such restrictions to protect your business. **Charles McCauley** can be reached at cmccauley@offitkurman.com or 484-531-1712, and **Sarah Goodman** can be reached at sarah.goodman@offitkurman.com or 267-338-1319.