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Axinn Antitrust Insight: FTC Issues Proposed Rule Banning Employee Non-Compete Clauses

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PRACTICE AREAS

Antitrust

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The 3 Things You Need to Know

- On January 5, the FTC issued a proposed rule that would broadly prohibit businesses from entering into non-compete clauses with any of their workers, regardless of role or salary.
- Businesses would also be required to rescind existing non-competes and affirmatively notify affected employees that they were no longer in effect.
- Now is the time for employers to evaluate their use of employee non-competes and assess whether the risk of an FTC challenge merits making preemptive changes. Unless the rule is enjoined by a court, the rule will likely go into effect in late 2023.

In a much anticipated move that is certain to be challenged in court, the Federal Trade Commission on Thursday published a proposed rule that would broadly ban businesses from entering into or enforcing non-compete agreements with their workers. The proposed rule is the latest and most significant step in the Biden Administration's efforts to promote labor market competition and the first in what FTC Chair Lina Khan has suggested could be a series of new rules to prohibit "unfair methods of competition." Chair Khan was joined by Commissioners Rebecca Kelly Slaughter and Alvaro Bedoya in supporting the proposed rulemaking, while Commissioner Christine Wilson (the lone Republican currently serving on the FTC) dissented.

The Proposed Rule

If enacted in its proposed form, the rule would prohibit any person or business from:

- Entering into or attempting to enter into a non-compete clause with any worker (whether paid or unpaid, employee or independent

contractor, etc.);

- Maintaining any non-compete clause with a worker; or
- Representing to a worker that he or she is subject to a non-compete clause unless the employer has a good faith basis to believe the employee is actually subject to an enforceable non-compete.

Those prohibitions are defined in broad and functional terms. The proposed rule defines a "non-compete clause" as 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, after the conclusion of the worker's employment with the employer." It also includes any provision (however labeled) that has the same functional effect, such as a non-disclosure agreement that is so broad that it effectively prevents the worker from working in the same industry after leaving the employer.

The FTC's proposed rule would require employers to rescind any non-compete clause in effect as of 180 days after the final rule is published and provide workers with specific written notice that they are no longer subject to such provision. Given the FTC's estimate that as many as 1 in 5 American workers may already be covered by non-compete clauses, that notice requirement could itself be a significant burden on many businesses.

The FTC did include one fairly narrow exception in its proposed rule: non-competes would be permitted when they are (1) entered into in connection with the sale of a business or a person's ownership interest in such business ***and*** (2) the person restricted by the non-compete was an owner, member, or partner holding a 25% or more interest in the business at the time the non-compete is agreed to. The proposed rule would also not limit non-competes entered into between business entities, such as at the sale of a business or in connection with a joint venture (although ordinary antitrust law would continue to apply to such agreements).

Next Steps

Before the rule can be adopted in final form, the FTC will accept public comments for 60 days from the publication of the Notice of Proposed Rulemaking in the *Federal Register*. The FTC has specifically requested comments on a number of issues, including the extent to which non-competes are currently used, their positive and negative effects on workers and businesses (and scholarly literature analyzing those effects), whether

the rule should have broader exceptions (e.g., for high-wage workers), and the potential effectiveness of alternative approaches (both for businesses to protect their legitimate interests without non-compete clauses and for the FTC to achieve its goals of preserving labor market competition). The substance of the comments received and the agency's response to them could influence whether the rule will ultimately survive judicial review.

And it is virtually certain that any final rule promulgated by the FTC will be promptly challenged in court. Commissioner Wilson's dissenting statement provides a roadmap for some of the many arguments that will likely feature in such litigation.

First, on the merits, she points to the long history of treating the legality of non-competes as a fact-bound, case-specific question unsuited to a categorical rule as well as calling into question the empirical evidence cited in support of the rule.

Second, she highlights the substantial legal questions regarding the FTC's authority to promulgate the rule. As she notes, while the FTC has frequently issued rules under its consumer protection mandate to prevent "unfair deceptive acts and practices," the FTC's statutory authority to define "unfair methods of competition" through rulemaking is questionable.

If you have any questions about the FTC's proposed rule, are interested in potentially submitting comments, or would like to discuss any other issue raised in this Insight, please contact any of Axinn's antitrust partners.