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Legal Update

FTC Proposed Rule Banning Noncompete Clauses

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On January 5, 2023, the Federal Trade Commission ("FTC") proposed a sweeping federal rule to ban noncompete clauses, arguing that such agreements are unacceptably detrimental to employees and the broader economy. The proposed rule is currently undergoing a 60-day public comment period, following which the proposed rule can be published and, if no changes are made, take effect as a final rule.

The FTC's rule would make most noncompete provisions unenforceable. As a result, while the proposed rule has no immediate impact, each employer should be aware of the proposed rule and its broad scope so that it can take stock of its existing noncompete agreements and consider the proposed rule's implications in future employment agreements.

What would the proposed rule prohibit?

The proposed rule would prohibit employers and workers from entering into noncompete agreements, which the rule defines 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."

Significantly, the FTC broadly defines "worker" to include employees, independent contractors, sole proprietors, volunteers, interns, and ***any other person who works for an employer, with or without pay***. There are no exceptions or carveouts based on an employee's position, access to confidential information, or compensation level.

The proposed rule would also nullify existing noncompete agreements, as the proposed rule applies retroactively. The proposed rule would require employers to rescind existing noncompete agreements and to explicitly notify current and former employees that the noncompete agreements may not be enforced against them. The final rule would provide sample language for the notification, which must be made by employers within forty-five (45) days of the rescission.

What would not be prohibited by the proposed rule?

While the proposed rule is broadly written, it does not, on its face, affect the legality of other restrictive covenants, such as non-disclosure agreements or non-solicitation agreements. Non-disclosure and non-solicitation agreements are distinct from non-compete agreements, as the former prohibits disclosure of an employer's confidential information and trade secrets, and the latter prohibits an individual from soliciting an employer's customers or employees for hire. Such restrictive covenants are not touched by the proposed rule, so long as the covenants are not so unusually broad in scope that they function to restrict a worker from working for a competitor, therefore amounting to a *de facto* noncompete. If such restrictive covenants are the functional equivalent of a noncompete, they too may be unenforceable under the proposed rule.

The proposed rule is limited to employment-related noncompete clauses between employers and workers. This means that the proposed rule does not apply to noncompete clauses between two businesses, where neither business is a "worker" as that term is defined by the FTC.

In addition, the proposed rule would not apply to concurrent-employment restraints—*i.e.*, restrictions on what the worker may do during the worker's employment with the employer.

Will the final rule be challenged?

If the final rule becomes effective, it will undoubtedly face numerous legal challenges, including arguments that the rule exceeds the FTC's administrative rulemaking authority. The rule could also be challenged as unconstitutional under a number of arguments, including that it interferes with the freedom to contract under the Due Process Clause; that it disproportionately affects a certain category of workers, implicating the Equal Protection Clause; or that it is an overreach of federal power in an area state law governs. The proposed ban may also run afoul of federal antitrust laws, as opponents will argue that the FTC is improperly regulating the competitive landscape between companies.

Such legal challenges can be anticipated to play out for months and years to come. For now, both employers and employees should take this proposed rule into account in their analysis of present and future employment agreements.

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