



Alerts

FTC Announcement That it Plans to Ban Noncompetes Generates Employment Law Shockwave

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Insights for Employers

The Federal Trade Commission (FTC) [promulgated proposed rules on January 5, 2023](#), which would ban noncompete agreements on a nationwide basis. The 60-day period for public commentary has now begun, and the proposed rules will not take effect until the final version is published, which is anticipated to take effect 180 days after the public comment period; however, it could take longer if there are legal challenges. Legal challenges are, in fact, very likely as the FTC has not traditionally been a regulator of labor and employment matters, and it is debatable whether noncompete agreements with individual employees fall under Section 45 of the FTC Act (15 U.S.C. § 45(a) giving the FTC power to bar "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce," which the agency invokes as its authority for the new proposed rules.

The proposed rules come in five parts, even though they are referred to as "a rule" by the FTC: §910.1, "Definitions," §910.2, "Unfair Methods of Competition," §910.3, "Exception," §910.4, "Relation to State Laws," and §910.5, "Compliance Date." The proposed rules apply to a broad array of "business entities," ("a partnership, corporation, association, limited liability company, or other legal entity, or a division or subsidiary thereof") and to "workers," broadly defined, i.e. "a natural person who works, whether paid or unpaid, for an employer. The term includes, without limitation, an employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer." The definition of "worker" does explicitly exclude a franchisee however. The proposed rules define a "noncompete agreement" 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." They provide for a "functional test" embracing any "contractual term that is a de facto noncompete clause because it 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," and specifically state that a nondisclosure agreement or a provision compelling reimbursement of the employer for training costs may be deemed a "noncompete agreement" if they are sufficiently broad and have the practical effect of preventing competition.

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The proposed rules provide that "[i]t is an unfair method of competition for an employer to enter into or attempt to enter into a noncompete clause with a worker; maintain with a worker a noncompete clause; or represent to a worker that the worker is subject to a noncompete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable noncompete clause." They require employers to rescind any pre-existing noncompete agreements, and to notify employees of the rescission and of the new FTC rules barring such provisions. They exempt only noncompetes entered into as part of the sale of a business or substantially all the assets of a business. ("entered into by a person who is selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity, or by a person who is selling all or substantially all of a business entity's operating assets, when the person restricted by the noncompete clause is a substantial owner of, or substantial member or substantial partner in, the business entity at the time the person enters into the noncompete clause.") And they purport to preempt all inconsistent state laws of any kind.

The proposed rules make no pretense of being limited to "business entities" or "workers" who operate across state lines or otherwise engage in interstate commerce.

The proposed rules will effectively nullify state law in 49 of the 50 states (excepting California) and create federal preemption over a regulatory field previously left to the states, without any accompanying federal legislation. The FTC claims that the proposed rules will result in a \$300 billion per year increase in wages across the economy. While the agency alludes to "studies," the empirical basis for that assertion is unclear. The agency does not seem to have made any attempt to consider the impact of the proposed rules on employers, or to have anticipated any unintended consequences for employees. Nondisclosure agreements are specially cited as a type of contract which may fall under the "functional test" for a noncompete, but it must be presumed that a nonsolicitation agreement would also be considered a noncompete for purposes of the proposed rules under many, if not most circumstances. The FTC's press release claims "the proposed rule would generally not apply to other types of employment restrictions, like non-disclosure agreements," and the FTC gives lip service to preservation of trademark law, but the broad ban on nondisclosure agreements will likely impact employers' ability to satisfy the Uniform Trade Secrets Act's requirement of "reasonable measures" to maintain the secrecy of trade secrets, as that has traditionally been held to include nondisclosure agreements and often noncompetes as well.