

# Publications

## FTC Proposes Rule to Ban Non-Compete Agreements

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On January 5, 2023, the Federal Trade Commission (FTC) proposed a new rule that would make it illegal for employers to enter into non-competes and require employers to rescind existing non-competes. The rule would further preempt all conflicting state and local laws. Prior to issuing a final rule, there is a notice and comment period during which the public may submit comments to the FTC regarding the proposed rule. That period runs through March 6, 2023.

Key provisions of the proposed rule are discussed below.

### Who is covered by the proposed rule?

The rule broadly applies to any person who “works” for an employer, including independent contractors, who provide a service to a client or customer. The rule excludes a franchisee in the context of a franchisee-franchisor relationship (but individuals who work for the franchisee or franchisor are covered).

### What does the proposed rule prohibit?

Under the rule, it will be an “unfair method of competition” for an employer: (1) to enter into or attempt to enter into a non-compete clause with a worker; (2) maintain a non-compete clause with a worker; or (3) represent to a worker that the worker is subject to a non-compete clause where the employer lacks a good faith basis to believe that the worker is subject to an enforceable non-compete clause.

### What is a “non-compete clause”?

A non-compete clause is a contractual term between an employer and worker that prevents the worker from seeking or accepting certain employment, or operating certain businesses, after the worker’s employment ends. Under the proposed rule, a “functional test” will be used to determine whether a contractual term is a non-compete clause (but the proposed rule fails to explain what this test is).

The proposed rule further prohibits “de facto non-compete clauses.” This would be any clause that has the “effect” of prohibiting a worker from seeking or accepting employment or operating a business at the end of employment. The rule provides two examples of such clauses:

- A non-disclosure agreement written so broadly that it effectively precludes the worker from working in the same field after employment ends.
- A contract that requires the worker to repay training costs if the worker’s employment terminates within a specified time period, where the payment is not reasonably related to the costs the employer incurred for training the worker.

The proposed rule does not otherwise prohibit non-disclosure, confidentiality, or non-solicitation agreements – unless the agreement fails the “functional test” or is deemed to be a “de facto” non-compete clause.

## What actions must an employer take if it has non-compete clauses?

If the FTC adopts the proposed rule, employers must rescind all preexisting non-compete clauses by the rule’s compliance date. The employer would need to provide an individualized notice in paper or digital format (e.g., email or text) to current workers that the non-compete clause is no longer in effect and may not be enforced. The notice would need to be provided within 45 days of rescission (providing notice would comply with the rescission requirement). The employer would also need to provide such notice to former workers if it has their contact information “readily available.” The rule sets out a model form employers can use to provide the notice.

## Does the proposed rule provide any exceptions?

There is a narrow exception related to non-compete clauses entered into by: (1) a person who is selling a business or otherwise disposing of all of the person’s ownership interest in the business; or (2) a person who is selling all or substantially all of a business’ operating assets. The exception applies only when the person restricted by the non-compete clause is a substantial owner in the business. “Substantial” means holding at least a 25% ownership interest.

## What happens next?

The public may submit comments to the FTC through March 6, 2023, after which the FTC may issue a final rule. If made final, the proposed rule would become effective 60 days thereafter. However, employers would have 180 days after the rule becomes final to comply. It is probable that any final rule will be challenged in court.

If a company has concerns about this rule, it may submit comments; after the public comment period proposed rules are often narrowed or even abandoned by the proposing agency.

Contact your Vorys lawyer if you have questions about the FTC’s rule, the notice and comment period, or about non-competition agreements in general. Vorys’ antitrust attorneys are currently working with clients across industries to submit comments on their behalf.