

The Federal Trade Commission Proposes Rule Banning Non-Compete Agreements

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In a sweeping proposal, the Federal Trade Commission has moved to ban non-compete clauses, claiming they constitute unfair competition. The proposed rule deems non-compete agreements in violation of Section 5 of the FTC Act.

We have previously written about the various headwinds that non-compete agreements have faced, both at the state and federal level, including the Department of Justice's use of the [antitrust laws](#), and President Biden's July 2021 [Executive Order](#) on Promoting Competition, which directed a "Whole-of-Government" review of competition policy. That Executive Order specifically called on government agencies, including the Federal Trade Commission ("FTC"), to "provide a coordinated response to overconcentration, monopolization, and unfair competition in or directly affecting the American economy."

The Proposed Rule Bans Non-Compete Agreements

On January 5, 2023, the FTC followed through on that Executive Order and published a Proposed Notice of Rulemaking (the "[Proposed Rule](#)") which classifies essentially all non-compete (and some non-disclosure) agreements as a form of "unfair competition," rendering them unenforceable. Specifically, the Proposed Rule states that "[i]t is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker," to "maintain with a worker a non-compete clause," or to "represent to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause." See Proposed Rule §910.2(a). In addition, the Proposed Rule requires employers to rescind existing non-compete agreements (§910.2(b)(1)) and to provide each employee with notice of their unenforceability in the form prescribed by the Proposed Rule (§910.2(b)(2)).

Definition of Non-Competes

The Proposed Rule broadly defines a non-compete clause as any contract term between an employer and "a worker that prevents a worker from seeking or accepting employment . . . or operating a business, after the conclusion of the worker's employment with the employer." Proposed Rule 910.1(b)(1). The Proposed Rule would employ a functional test and treat any contract clause that has the *effect* of prohibiting a worker from accepting employment as a non-compete clause. This includes a non-disclosure agreement that is so broad as to effectively prevent the employee from working in the same industry or a contract provision requiring an employee to pay the employer for training costs if the amount of the payment is not reasonably related to the actual costs incurred in training. Proposed Rule 910.1(b)(2).

Agreements not to solicit clients or other employees seem to fall outside the definition of banned non-competes in the Proposed Rule as long as they are not drafted so broadly as to prevent a worker from accepting employment in the same industry. The Proposed Rule does not specifically address whether provisions in long term incentive compensation agreements in which an employee forfeits unvested or vested equity awards would fall within the Proposed Rule's definition of a non-compete agreement.

Exceptions

The Proposed Rule creates an exception that allows the use of a non-compete provision if (a) that clause was part of the sale of a business where the employee was “selling a business entity or otherwise disposing of all of the person’s ownership interest in the business entity” or was “selling all or substantially all of a business entity’s operating assets” and (b) the employee was “a substantial owner of, or substantial member or substantial partner in, the business entity at the time the person enters into the non-compete clause.” See Proposed Rule §910.3.

Preemption

Finally, the Proposed Rule preempts and “supersede[s] any State statute, regulation, order, or interpretation to the extent that such statute, regulation, order, or interpretation is inconsistent with this Part 910.” See Proposed Rule §910.2(a). Many states, including New York, allow the use of narrowly tailored non-competes to protect the legitimate interests of the employer, particularly trade secrets, confidential information, and good will with clients. The Proposed Rule, however, seems to assert that (outside of the sale of a business), employers do not have any legitimate interests that would justify the use of a non-compete.

Comment Period

The FTC’s Proposed Rule, if enacted and enforced, would upend this entire area of law. There will be a comment period during which employers and others can give the FTC comments on the Proposed Rule, and the FTC will then decide whether to go forward, amend or abandon the Proposal Rule. As would be expected, the Proposed Rule has already drawn backlash from pro-employer organization, like the Chamber of Commerce, and is almost certain to be challenged (including on grounds that the FTC exceeded its rulemaking authority) if it is enacted.

Please follow us for notices of subsequent action on this Proposed Rule and for more details about the implications of the FTC’s position on non-competes.

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