



## FTC PROPOSES SWEEPING, NATIONWIDE BAN OF NON-COMPETES

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Last Thursday, the Federal Trade Commission introduced a proposed rule that would impose a nationwide ban on non-compete agreements in all but a limited number of cases. The FTC cited, among other things, wage suppression as justification for the proposed rule. The rule will not go into effect, if at all, for several months, yet it represents the next step in the Biden Administration's efforts to curtail the use of non-compete agreements throughout the country. The proposed regulation, which would preempt all conflicting state laws governing non-competes, comes after the President's 2021 [executive order](#), directing the FTC to develop the rule.

**What it is:** The rule is an outright ban on non-competes except in business purchase agreements. Accordingly, if one business acquires another business, the purchase agreement may contain an enforceable non-compete, protecting the ongoing business purchased by the acquiring company. All other non-competes would be unenforceable. The rule proposes a "functional test" to determine whether a contract provision constitutes a non-compete and bans any contract term that:

- *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.*

The rule specifically bans non-disclosure agreements that would "effectively preclude" a worker from "working in the same field" after the end of their employment and contract terms that require an employee to pay for training costs "when the costs are not reasonably related" to the costs the employer incurred in training the employee. The "functional test" is not limited to these two categories. Notably missing from the proposed rule is an exception included in previously proposed legislation for highly compensated individuals, such as upper-level managers and C-suite executives. The rule also requires

employers to rescind all current non-competes and give employees notice that their non-competes are no longer enforceable.

***When it takes effect:*** The rule cannot take effect for at least eight months: the public has sixty days to provide comments to the proposed rule and then, if the FTC finalizes the rule, it will not go into effect for another 180 days. Most likely, the process will take longer. In response to comments, the FTC may propose one or more revisions to the current version of the rule, each of which will be subject to additional rounds of public comment. Also, even if the FTC finalizes the rule, it will face legal challenges in court. As part of those challenges, courts may stay enforcement of the rule while it makes its way through the appellate process.

***Potential legal challenges:*** Before the proposed rule, or a revised version of it, goes into effect, it could be challenged in court. Opponents have a number of objections to the rule. For instance:

- The retroactive effect of the rule could constitute an unconstitutional deprivation of an employer's property rights. Employers will argue that a taking of property occurred if their bargained-for non-compete rights are stripped without recourse or compensation.
- It is unclear whether Congress delegated authority to the FTC to regulate non-competes. As the FTC is part of the executive branch, its "rulemaking" authority is limited to those areas Congress delegates to the FTC. Ordinarily, the FTC or the Department of Justice must challenge a non-compete through case-by-case adjudication under the antitrust law "rule of reason." By seeking to ban all non-competes by rule, the FTC may be attempting an end run around the adjudicative process.
- A legal challenge could implicate the federal government's ability to regulate commerce. Under the commerce clause, the federal government does not have the power to regulate purely intrastate commerce. Opponents could challenge the rule's ability to regulate a non-compete limited in scope to one state, such as a non-compete with a geographic scope entirely within a given state or that is limited to only employees or customers within a given state.

***Ambiguities in proposed rule:*** Even if the rule survives legal challenge, ambiguities in the rule leave much for interpretation. The "functional test" leaves open the question of what kind of contract provisions would "have the effect of prohibiting" a worker from "seeking or accepting" subsequent employment. It is unclear whether the rule would render unenforceable a non-compete provision that proscribes an employee's ability to perform certain job duties for a subsequent employer or prohibits the employee from soliciting the former employer's clients or employees. Though the proposed rule expressly prohibits certain non-disclosure agreements, it does not address by name "non-solicitation" agreements that prevent contact with particular clients or customers. The gap may leave room to craft provisions that test the parameters of the proposed rule, though—it goes without saying—such attempts may face court scrutiny.

***How employers should respond:*** The rule has not gone into effect yet and will not become effective for some time, if at all. Employers should plan to invest in carefully crafted contract provisions that both protect their business interests and comply with the rule, should it go into effect. The time is now to meet



with qualified legal counsel to navigate the law governing restrictive covenants and to take proactive steps to protect your business if the FTC's proposed rule banning non-competes takes effect.

## Related Practices

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