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Overbroad and Overstepping? FTC Moves to Ban Non-Competes Nationwide

January 18, 2023
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Only days into the new year, the Federal Trade Commission (FTC) announced a controversial proposed rule that would potentially ban all non-compete agreements nationwide. While the proposed rule would not take effect until the end of a 60-day public comment period, at the earliest, it has left employers wondering how they can protect their businesses should it become binding? The actual impact of the proposed rule depends on the legal challenges and substantial revisions the rule is likely to face, but, at this point, here is what employers need to know.

The Broad Reach of the Proposed Rule

The proposed rule has extraordinarily broad reach. It defines a "non-compete clause" 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." The term "worker" includes not only employees, but also independent contractors, externs, interns, volunteers, apprentices, and sole proprietors. Yet the proposed rule contains no exceptions based on a worker's role in the business, compensation level, or access to sensitive proprietary information. As such, the FTC intended the proposed rule to cover nearly all workers.

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Further, the proposed rule reaches beyond contract terms that restrict competition on their face. Instead, it implements a "functional test for whether a contractual term is a non-compete clause" including in its scope any term that "is a *de facto* non-compete 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." This even includes a non-disclosure agreement "that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer." Although the FTC does not provide guidance on what it considers unusually "broad," employers should review their agreements to determine whether the non-disclosure clauses are appropriately tailored.

The Proposed Rule Bans New Non-Competes And Rescinds Old Ones

Not only does the proposed rule bar any clause falling within its definition of a non-compete, but it also rescinds all existing non-compete agreements.

On top of that, it also requires employers with existing non-compete agreements with former and current employees not only to rescind the non-competition clause, but provide notice to all current and former employees of the rescission of the clause. The proposed rule includes model language that employers can use to provide notice to the worker.

That said, employers may use different language, so long as they notify workers in writing, on paper or electronically, that their non-compete clause is no longer in effect and may not be enforced against the worker. Therefore, employers should be prepared to issue notices to current and former workers whose contact information is readily available, should the final rule be issued in its current form.

Notably, the proposed rule supersedes any state "statute, regulation, order, or interpretation to the extent that such statute, regulation, order, or interpretation" that is inconsistent with the proposed rule. Thus, where states have restrictive covenant laws that allow for "blue penciling" provisions, allowing a state court to modify or delete overly broad restrictive covenants in an enforcement action, such laws would be federally preempted. Therefore, even if a worker's agreement includes a state specific non-compete clause that has been tailored to comply with state-specific nuances, even these clauses would be impermissible.

Available Exceptions

Although the proposed rule contains a limited exception for non-compete clauses between the seller and buyer of a business, this exception appears to only be available where the party restricted by the non-compete clause is an owner, member, or partner holding at least a 25% ownership interest in a business entity. What is not clear is if this provision applies both to equity and asset purchases. Employers should review their partnership agreements to confirm that the division of ownership does not enable disruption of transactions to de-value a business, whereby executives would be permitted to immediately create a competing business with proprietary information or client information after a deal closes, if the ownership interests of each executive or owning individual was under 25%.

Anticipated Legal Challenges

The U.S. Chamber of Commerce already has called the proposed rulemaking "blatantly unlawful," so, should the proposed rule take effect, it likely will be subject to legal challenges. Additionally, the proposed rule is still in its early stages, so employers should review their agreements to confirm that they are compliant with the state specific laws and regulations applicable, but do not need to immediately remove non-compete clauses.

The proposed rule also could lead to increased litigation between employers and current or former employees, due to the requirement to rescind all non-compete clauses. Notably, despite the requirement to rescind the non-compete clauses, there are no guidelines for whether or how current and former workers should repay the compensation that was exchanged for such clauses. Further, since the proposed Rule applies to former workers, many of whom employers may not have up-to-date contact information for, employers will have no recourse for the repayment and the FTC has not explained what enforcement mechanism an employer could utilize to receive repayment of the consideration from the current or former worker. It is similarly unclear whether rescission of payment then means other provisions of the agreements would be tolled pending repayment. As repayment could implicate tax issues, such as whether an employer has to report refunded compensation as income, employers should confirm the tax implications and recourse for repayment, should the proposed rule be enacted.

Next Steps

We will continue to closely monitor the developments. Employers with questions or concerns about the proposed rule on currently drafted restrictive covenants and the enforcement thereof can check with their Akerman Labor & Employment attorney.
