

FTC Releases Proposed Non-Compete Clause Rule

Labor and Employment Alert
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On January 5, 2023, the Federal Trade Commission (FTC) released a Notice of Proposed Rulemaking to prohibit employers from entering into non-compete clauses with workers and require employers to rescind existing non-compete clauses. Proponents argue that non-compete clauses hold American workers “hostage” by keeping wages low and suppressing new businesses and innovation.

Dissenters, on the other hand, contend that, “the proposed rule is a radical departure from hundreds of years of legal precedent that employs a fact specific inquiry into whether a non-compete clause is unreasonable in duration and scope, given the business justification for the restriction.” Commissioner Christine S. Wilson further noted in her dissent that, “the Commission undertakes this radical departure despite what appears at this time to be a lack of clear evidence to support the proposed rule. What little enforcement experience the agency has with employee non-compete provisions is very recent (within the last week) and fails to demonstrate harm to consumers and competition. Lacking enforcement experience, the Commission turns to academic literature – but the current record shows that studies in this area are scant, contain mixed results, and provide insufficient support for the scope of the proposed rule. And one study illustrates clearly, in the financial services sector, the negative unintended consequences of suspending non-compete provisions, including higher fees and broker misconduct. The suspension of non-competes across all industry sectors in the U.S. undoubtedly will impose a much larger raft of unintended consequences.”

Rationale

In her January 5, 2023 statement, Chair Lina M. Khan, stated that “the freedom to change jobs is core to economic liberty and to a competitive, thriving economy. Non-competes block workers from freely switching jobs, depriving them of higher wages and better working conditions, and depriving businesses of a talent pool that they need to build and expand.” The proposed rule will “promote greater dynamism, innovation, and healthy competition.”

The goal of the proposed rule is to increase wages, promote new businesses and novel innovation, and expand economic liberty. According to the Commission, the proposed rule would expand career opportunities for nearly 30 million American workers, increase workers’ earnings by nearly \$300 billion per year, save consumers up to \$148 billion annually on health care costs, and double the number of companies founded by a former worker in the same industry.

The Proposed Rule

The proposed rule would add a new subchapter J, consisting of Part 910.

Definitions

In the proposed rule, the Commission 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 proposed rule also provides a functional test for whether a contractual term is a non-compete clause. “The term non-compete clause includes a contractual 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. For example, the following types of contractual terms, among others, may be de facto non-compete clauses: (i) a non-disclosure agreement between an employer and a worker 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; and (ii) a contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker."

Both employer and worker are broadly defined. Under the proposed rule, an employer is "a natural person, partnership, corporation, association, other legal entity, or any person acting under color or authority of State law, that hires or contracts with a worker to work for the person." Worker is defined as "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." Notably, the definition of worker includes independent contractors and provides only a limited exception for franchisees in a franchisee-franchisor relationship.^[1]

Unfair Methods of Competition

Section 5 of the Federal Trade Commission Act declares "unfair methods of competition" to be unlawful. Section 5 further directs the Commission "to prevent persons, partnerships, or corporations ... from using unfair methods of competition in or affecting commerce." Section 6(g) of the Act authorizes the Commission to make rules and regulations for the purposes of carrying out the provisions of the Act, including the Act's prohibition of unfair methods of competition. The Commission draws its authority to promulgate the proposed rule from Section 6(g).

Under the proposed rule, "it is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or 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."

As for existing non-compete clauses, the proposed rule includes a *rescission requirement* no later than the compliance date.^[2] Additionally, an employer that rescinds a non-compete clause must provide notice to the worker that the worker's non-compete clause is no longer in effect and may not be enforced against the worker. Such notice is required to be given in an individualized communication but can be provided on paper or in a digital format.^[3] The notice requirement extends to both current and former workers of the employer, provided the employer still has the former worker's contact information readily available.

Exceptions and Supremacy

The proposed rule provides for a narrow exception: "a non-compete clause that is entered into by a person who is selling a business entity^[4] 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 non-compete clause is 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. Non-compete clauses covered by this exception would remain subject to Federal antitrust law as well as all other applicable law."

The impact of the proposed rule would be far-reaching. The proposed rule provides: "Part 910 shall supersede any State statute, regulation, order, or interpretation to the extent such statute, regulation, order, or interpretation is inconsistent with Part 910."^[5]

Comment Period

In accordance with its notice and comment requirement, the Commission invites the public to submit comments on the proposed rule within sixty (60) days of its publication in the Federal Register. The Commission is particularly interested in whether franchisees should be covered by the rule; whether senior executives should be exempted from the rule, or subject to a rebuttable presumption rather than a bar; and whether low-wage and high-wage workers should be treated differently under the rule.

Following the comment period, the Commission will review the comments and may make changes, in a final rule, based on the comments and the Commission's further analysis of the issue. Compliance with Part 910 will be required 180 days after the date of publication of the final rule.

[1] Non-compete clauses between franchisors and franchisees would remain subject to Federal antitrust law as well as other applicable law.

[2] The compliance date is 180 days after the date of publication of the final rule.

[3] The proposed rule includes that the employer may provide notice by way of text message or email.

[4] A business entity is a partnership, corporation, association, limited liability company, or other legal entity, or a division or subsidiary thereof.

[5] The proposed rule would not interfere with a State statute, regulation, order, or interpretation that affords any worker greater protection than provided under the proposed rule.

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