

## FTC PROPOSES RULE TO BAN NON-COMPETE CLAUSES

January 10, 2023

On January 5, 2023, the Federal Trade Commission (“FTC”) proposed a sweeping rule that, if enacted as initially drafted, will prohibit employers from entering into or enforcing existing non-competition agreements with executives and other employees.

### BACKGROUND AND LEGAL JUSTIFICATION

The FTC’s proposed rule comes on the heels of several years of discussion by the federal government regarding the potential regulation of non-competes by the FTC. In January 2020, the FTC held a workshop entitled “[Non-competes in the Workplace: Examining Antitrust and Consumer Protection Issues](#)” to examine whether there was a sufficient legal basis to promulgate a rule restricting the use of non-competes in employment contracts. And on July 9, 2021, President Biden issued an “Executive Order Promoting Competition in the American Economy,” which encouraged the FTC to examine the unfair use of non-compete clauses. [Executive Order 14036](#).

Until last week, the FTC had not issued any rules or regulations pursuant to Executive Order 14036. The FTC has now proposed a ban on nearly all non-competes based on the FTC’s findings that such agreements unfairly prevent competition in violation of [Section 5 of the Federal Trade Commission Act](#). If enacted, this rule will supersede all inconsistent state statutes, regulations, orders, and interpretations.

### THE FTC’S PROPOSED RULE

The FTC’s proposed rule broadly 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.” This includes “*de facto* non-compete clauses” that effectively prohibit an employee from seeking or accepting employment with a person or operating a business after the conclusion of the employee’s employment with the employer. For example, when a non-disclosure agreement is so broadly written that it effectively precludes an employee from working in the same field after the employee’s termination, this agreement would be considered a “non-compete.” More narrowly drawn non-disclosure and confidentiality agreements will remain allowable, as will certain non-solicitation agreements.

Under the FTC's proposed rule, an employer may not: (1) enter into or attempt to enter into a non-compete clause with an employee; (2) maintain a non-compete clause with an employee; or (3) represent to an employee that the employee is subject to a non-compete clause where the employer has no good faith basis to believe that the employee is subject to an enforceable non-compete clause. To comply with this requirement, an employer that had previously entered into a non-complete clause with an employee must rescind the non-competition agreement. Further, the employer must provide notice to current employees, as well as former employees, that the employees' non-competition agreements are no longer in effect and will not be enforced against the employees. The FTC provides model language for this notice, which can be found here: [https://www.ftc.gov/system/files/ftc\\_gov/pdf/p201000noncompetenprm.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf). Employers are not required to use this language provided that an employer's notice communicates to an employee that the employee's non-compete clause is no longer in effect and will not be enforced against the employee.

The proposed rule provides a narrow exception allowing an agreement that restricts competition when a person is selling a business entity, or otherwise disposing of all their ownership interest in the business entity, or when a person is selling all or substantially all of a business entity's operating assets. In these situations, a non-compete is permissible when the person restricted is a substantial owner of, or substantial member or substantial partner in, the business entity at the time they enter into the non-compete. A person is a substantial owner, member, or partner if they hold at least a twenty-five (25) percent ownership interest in a business entity.

## CONCLUSION

Currently, the FTC's suggested rule is only a proposal. The public will have sixty (60) days to submit [comments](#) on the proposed rule once it is published in the *Federal Register*. After this comment period, the FTC will review these comments, edit, and finalize the rule. Thus, the proposed rule may undergo changes before becoming effective. The proposed rule is also likely to face [legal challenges](#) regarding whether the FTC has the regulatory authority to impose such a rule. Employers do not need to rescind their non-competition agreements at this time. However, this is an ideal time to review whether existing confidentiality, non-solicitation, and non-competition agreements are effective and compliant with current law. With the shift to remote work and telehealth, revisions may be needed to provide protection for a party's legitimate business interests and current operating models.

If you have questions or need assistance regarding non-competition agreements or other employment laws, please contact a member of Hancock Daniel's [Labor & Employment](#) team.

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