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FTC Proposes New Rule Essentially Banning Employee Non-Competition Clauses: Is the End in Sight for Non-Competes?

On January 5, 2023, the Federal Trade Commission (FTC) published a Notice of Proposed Rulemaking advancing a new rule that would effectively prohibit employee non-competition clauses with all employees and rescind existing non-competition clauses. All workers, whether paid or unpaid, and independent contractors, interns or volunteers would be covered. While there is nothing employers must do now, if the rule as proposed takes effect it will have a sweeping impact on the ability of businesses to limit the employment of their workers post-employment.

The Proposed Rule

The proposed rule broadly defines non-compete agreements 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."

It also provides a functional test for when a contractual term constitutes a non-compete clause. Specifically, it provides that a term is a non-compete clause when it has "the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after conclusion of the worker's employment with the employer."

The proposed rule does not specifically prohibit non-disclosure agreements. However, a non-disclosure agreement could be unlawful under the proposed rule if drafted "so broadly" that it "effectively precludes the worker from working in the same field after the conclusion of the worker's employment."

The Proposed Rule's Rescission Requirement and Exceptions

The proposed rule also would require employers to rescind all existing non-compete clauses within 180 days of the final rule's publication. In addition, employers would have to provide written notice in an individual communication to all workers who had such clauses rescinded within 45 days of the rescission.

The proposed rule does not apply to non-compete agreements entered into as a

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part of the sale of a business. It also exempts "franchisees" in a franchisee-franchisor relationship, although those agreements remain subject to federal antitrust law.

The proposed rule also explicitly preempts any inconsistent state law. State laws, regulations, orders or interpretations that afford workers greater protection are not inconsistent with the proposed rule.

FTC Takes Action Under Current Rules

The FTC's proposed rule came one day after it announced the filing of complaints against three Michigan companies over what the FTC charges to be unlawful use of non-competition agreements with employees under the FTC's *existing* rules. This is the first time the FTC has challenged such agreements between employers and employees and foreshadows that the FTC will act aggressively to address actions it considers anti-competitive, even under existing rules.

What Employers Should Do Now

The FTC's proposed rule is not final, so no immediate action is required. Employers have 60 days to submit public comments, after which the FTC will publish a final version of the rule.

The FTC's proposed rule will likely face legal challenges, but regardless, the FTC's recent moves demonstrate that it will actively seek to address practices it considers anti-competitive. This is something employers should continue to monitor.

The one-two punch of the FTC's actions underscores its view that it has the power to regulate employee non-competition agreements, even without the proposed rule. Therefore, employers should carefully review and revise their non-compete clauses to ensure those are as narrow as possible and only impose such restrictions on employees who pose a competitive risk.

Please contact Matt DeLange, Lynn Stathas or your Reinhart attorney if you have any questions, need help reviewing a non-compete agreement or would like to submit a public comment to the FTC.

represent you.