Employment & Labor Law Alert

January 2023

Unpacking the FTC Proposed Rule Banning Use of Noncompetes

The Federal Trade Commission (FTC) has proposed a new rule that would effectively ban the use of noncompete clauses nationwide on both a prospective and a retrospective basis. The proposed rule, announced Jan. 5, would provide that it is an "unfair method of competition" for an employer to enter into a noncompete clause with a worker, thus rendering such clauses unlawful under Section 5 of the Federal Trade Commission Act. The proposed rule would extend to all workers, whether paid or unpaid, and would require employers to rescind any existing noncompete agreements.

If adopted, the rule would not become effective for at least 240 days, as it must first enter a 60-day comment period (which could be extended) followed by a 180-day notice period. While it is likely to face substantial opposition and may be altered or even struck down, the proposed rule reflects the recent trend toward limiting or prohibiting the use of noncompete agreements nationwide.

Definitions and Scope

Noncompete clause: The proposed rule defines "noncompete 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." While the definition of "noncompete clause" excludes other types of restrictive employment covenants, such as nondisclosure agreements, confidentiality agreements, and client or customer nonsolicitation agreements, which employers may continue entering into with workers, these agreements would be treated as noncompetes under the proposed rule if they are so unusually broad in scope that they function as "de facto noncompete clauses."

The proposed rule provides the following two examples of de facto noncompete clauses:

1. A nondisclosure 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.
2. 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.

While some ambiguity remains as to what other types of provisions may fall under this definition, employers should tailor their contractual terms narrowly to avoid the type of overbroad provisions that may be deemed de facto noncompete clauses under the proposed rule.

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Employers and workers: The proposed rule would apply only to noncompete clauses between employers and workers, not those between two businesses, such as in a franchisor-franchisee relationship. "Employer" is defined as "any natural person, partnership, corporation, association, or other legal entity, including any person acting under color or authority of state law, that hires or contracts with a worker to work for the person." The proposed rule would apply not only to employees but to all "workers," defined to include independent contractors, externs, interns, volunteers, apprentices and sole proprietors who provide a service to a client or customer, whether paid or unpaid, and without regard to whether the worker is classified as an employee under the Fair Labor Standards Act (FLSA) or similar statutes. The proposed rule also notes that gig economy workers, such as rideshare drivers, would be considered workers for purposes of the rule.

Key Provision Banning and Rescinding Existing Noncompetes

Ban on noncompete clauses: The proposed rule would require employers to refrain from entering into, or attempting to enter into, new noncompete clauses starting on the rule's compliance date. Noting that employers may take advantage of workers who are unaware of their legal rights, the rule would also prohibit an employer from representing to a worker that they are subject to a noncompete clause when the employer has no good faith basis to believe that is so.

Rescission of existing noncompete clauses: The proposed rule would also require employers to rescind noncompete clauses entered into before the compliance date, by providing written notice to the worker that the noncompete clause is no longer in effect and may not be enforced. Employers may use the model language provided in the proposed rule to meet this requirement. This notice must be provided in an individualized communication (not a general posting), on paper or in a digital format (such as email or text message, but not orally), within 45 days of the rescission. Employers must provide this notice to all current workers subject to a noncompete clause as well as to former workers, provided that the employer has the former workers' contact information readily available.

Sale of business exception: The only exception under the proposed rule would allow noncompete clauses barring the seller of a business from competing with the purchaser. This exception would apply only to an owner, member or partner holding at least a 25% interest in a business entity, and any noncompete clause would remain subject to other antitrust laws.

Preemption: The proposed rule contains an express preemption provision establishing that it supersedes any conflicting state law. A state law is not conflicting if it provides workers with greater protection than the proposed rule.

Enforcement: The proposed rule would allow the FTC to enforce rule violations under Section 5 of the FTC Act, but it does not create a private right of action for workers.

What This Means Today–and the Bigger Picture

The proposed rule is currently in the beginning stages of the rulemaking process and remains subject to change. Indeed, the rule itself offers softer alternatives that the public may comment on, such as replacing the categorical ban on noncompete clauses with a rebuttable presumption of unlawfulness, or creating exemptions for certain categories of workers. The public may submit comments on these alternatives, or on any other aspect of the proposed rule, during the 60-day comment period.

The rulemaking process may be delayed or derailed entirely by legal challenges. Given the sweeping nature of the proposed rule, substantial opposition is likely, and the proposed rule may even be struck down. Indeed, opponents of the rule immediately raised concerns that the FTC has overstepped its authority and argued that the rule should be invalidated as a result. While the FTC claims that it has the requisite rulemaking authority under Sections 5 and 6(g) of the FTC Act, opponents argue that the text of the rule does not clearly grant the FTC authority to regulate noncompete agreements, particularly as the agency has historically focused on antitrust and other consumer-facing matters. Known as the "major questions" doctrine, these challenges consider whether a federal agency is seeking to assert power beyond what Congress has authorized.

If successful, this would not be the first time that a proposed rule or regulation is struck down under the major questions doctrine. These questions regarding

a federal agency's rulemaking authority mirror similar challenges raised just last year, in which courts demonstrated a willingness to strike down proposed rules and regulations if the pertinent federal agency lacked clear congressional authority to promulgate them. In January 2022, the U.S. Supreme Court struck down the Occupational Safety and Health Administration's (OSHA) COVID-19 Vaccination and Testing Emergency Temporary Standard (ETS), by which OSHA sought to impose vast testing and vaccination requirements. The court in *Nat'l Fed'n of Indep. Bus. v. DOL, OSHA*, held that OSHA did not have the rulemaking authority to promulgate the ETS, reasoning that the Occupational Safety and Health Act "empowers [OSHA] to set *workplace* safety standards, not broad public health measures" (emphasis in original), and that the language of the act did not plainly confer on OSHA the authority to issue a rule as vast as the ETS. Similarly, in June 2022, the Supreme Court in *West Virginia v. EPA* rejected the Environmental Protection Agency's attempt to implement new measures to control greenhouse gas emissions, reasoning that the EPA sought to assert "highly consequential power beyond what Congress could reasonably be understood to have granted." Opponents of the FTC's proposed rule have raised similar arguments, and should courts follow in the example of these 2022 precedents, the FTC's proposed rule may ultimately be struck down.

Regardless of the outcome, however, the proposed rule is yet another step in the nationwide trend toward limiting or prohibiting noncompete clauses, and employers should expect that laws and regulations may be implemented in some form limiting the use of noncompetes. A growing number of states and the District of Columbia have passed legislation in recent years significantly restricting the use of noncompete clauses, including:

- District of Columbia (prohibiting the use of noncompetes except with highly compensated employees earning over $150,000/year, with 14 days' notice and limited to one year) (effective Oct. 1, 2022).
- Colorado (prohibiting the use of noncompetes except with highly compensated workers) (effective Aug. 10, 2022).
- Illinois (prohibiting the use of noncompetes for employees earning less than $75,000/year) (effective Jan. 1, 2022).
- Oregon (prohibiting the use of noncompetes except with highly compensated workers) (effective Jan.1, 2022).
- Nevada (noncompetes unenforceable for hourly workers) (effective Oct. 1, 2021).
- Virginia (noncompetes unenforceable with employees or independent contractors who qualify as low-wage earners under the Virginia Code) (effective July 1, 2020).
- Rhode Island (noncompetes unenforceable for workers classified as nonexempt under the FLSA, or who earn less than 250% of the federal poverty level) (effective Jan. 15, 2020).
- Washington (noncompetes unenforceable except with highly compensated workers) (effective Jan.1, 2020).
- Maryland (noncompetes unenforceable for employees earning less than $15/hour or $31,200/year) (effective Oct. 1, 2019).
- Maine (noncompetes unenforceable with employees earning less than 400% of the federal poverty level) (effective Sept.19, 2019).
- New Hampshire (noncompetes unenforceable for workers who earn an hourly rate 200% or less of the federal minimum wage) (effective Sept. 8, 2019).
- Massachusetts (noncompetes unenforceable against workers classified as nonexempt under the FLSA) (effective Oct.1, 2018).

This trend toward limiting the use of noncompete agreements is reflected in other states as well. New Jersey introduced a similar bill in May 2022 that remains pending, and three states (California, North Dakota and Oklahoma) have long had laws in place that void noncompete clauses in nearly all instances. The FTC's proposed rule serves as another step in this ongoing trend, and, regardless of the outcome of this rulemaking process, employers should expect that noncompete clauses will continue to face increased scrutiny in the coming years.

What Employers Should Be Doing Now

While the fate of the FTC's proposed rule remains uncertain, employers can take the following steps to prepare for possible changes in the enforceability of noncompetes:

- Review existing noncompete agreements to determine current enforceability in conjunction with applicable state law.
- Consider whether the time is right to impose restrictive covenants before the FTC or various state laws take effect.
- Review existing policies and agreements that protect confidential and proprietary information, customer lists, and other similar interests, and ensure they are sufficiently narrow to avoid treatment as de facto noncompete clauses.
- As necessary, develop alternatives to noncompete agreements (such as strong nonsolicitation agreements, nondisclosure agreements, advance-notice-of-resignation requirements and confidentiality covenants) to protect legitimate business interests and intellectual property.
- Consider commenting on the proposed rule during the 60-day comment period, which begins once the FTC publishes the notice of proposed rulemaking in the Federal Register.

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7201 REV1 01-20-2023