

FTC Takes First Step to Make Good on Promise to Curtail Non-Compete Agreements

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On January 5, 2023 the Federal Trade Commission (“FTC”) proposed a rule to ban most non-compete agreements (“non-competes”) for American workers. The text of the proposed rule is broad: provisions that prevent workers from seeking or accepting employment after leaving a current employer would be considered an “unfair method of competition” prohibited (with limited exception) under Section 5 of the Federal Trade Commission Act (“Section 5”). Moreover, the proposed rule includes a “rescission requirement,” designed to invalidate any existing non-competes and to require employers to notify (formerly) covered employees that their non-compete is no longer enforceable. Finally, the proposed rule makes a limited exception for agreements with individuals who are selling an ownership interest in a business. Notably, the proposed rule does not make an exception for senior executives. Nor does it address other means available to merging parties to protect a buyer’s interest in ensuring that valuable employees necessary for the selling business’s operations stay with the business (although such provisions are subject to other antitrust rules).

The proposed rule 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,” and “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.” While there is no explicit answer yet, the proposed rule appears inapplicable to contract provisions related to non-solicitation of customers and employees.

The enforceability of an employer’s non-compete agreements with its employees historically has been a question of state law. Some states have banned non-competes altogether, while others have limited employers’ ability to broadly use them. For example, in California, Colorado, and North Dakota, post-employment non-competes are void and unenforceable, with limited exceptions. States like Illinois, New Hampshire, and

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Washington use wage thresholds as a factor in non-compete enforceability. And in New Mexico, post-employment non-competes with healthcare practitioners are not enforceable.

This patchwork of state regulation is undoubtedly one of the reasons President Biden issued an Executive Order in July 2021, encouraging the FTC and other agencies to limit non-competes as a way to “promote competition in the American economy.” FTC Chairwoman Lina Khan has long argued that the agency should use its rulemaking authority under Section 5 to target “unfair methods of competition,” including employment non-competes.

The FTC’s proposal is in the earliest stages of the rulemaking process, and there are sure to be substantial developments to the final text of the rule—if it ever becomes a final rule—in the months and years ahead. The next step in the process is publication in the Federal Register, which will trigger a 60-day public comment period (and which is often extended for high-profile or complex issues). After public comment, the FTC may amend its proposed rule to address concerns or other issues raised during the comment period or (although unlikely) may abandon it altogether. Any final rule will go into effect 180 days after final publication in the Federal Register.

At that point—depending on the final text of the rule and myriad other factors—litigation over the FTC’s authority to implement such a rule is likely. Legal challenges to the rule could include arguments that (1) Congress did not grant the FTC authority to engage in rulemaking about “unfair methods of competition”; (2) the proposed rule exceeds the limits imposed by the Supreme Court’s “major questions” doctrine; and (3) the rule represents an impermissible delegation of legislative authority—all arguments cited by the lone dissenting commissioner, Christine Wilson, in her statement accompanying the FTC’s announcement of the proposed rule. The five-commissioner FTC currently has three Democrats and one Republican (with one vacancy), and no more than three commissioners can be members of the same political party. If legal challenges delay the effective date until after January 2025, the mix of commissioners on the FTC may have different priorities and policy viewpoints. All this to say that the rule could become effective in a matter of months, years, or not at all.

The upshot of the imminent procedural quagmire presented by the rulemaking process, and the time required for any related litigation about the enforceability of the rule, is that most employers need not worry that this rule will be adopted and enforced across the board overnight. That said, certain practical steps can help prepare employers to avoid future headaches while the process unfolds.

Review Non-Disclosure and Confidentiality Provisions and Agreements

Employers traditionally have used non-compete agreements as one tool to prevent employees from taking highly sensitive information—such as trade secrets, intellectual property, or other confidential information—from one job to the next. Employers would be wise to evaluate now how to protect their highly sensitive information through means other than a non-compete, such as strengthening confidentiality and non-disclosure

provisions or agreements already in use and using other means to prevent dissemination of such information. Employers should consider limiting the number of employees who have access to highly sensitive information, and ensure that those who do have access also have strong confidentiality agreements and receive training on their obligations to maintain confidentiality during and after employment.

Employers may also want to revisit whether non-competes are being used in template agreements for employees that do not have access to highly sensitive information, or for positions where, unlike those addressed in the next section, training and other up-front investment in new employees is less prevalent.

Analyze Retention Policies and Strategies

In addition to safeguarding highly sensitive information, a major upside of non-competes for employers has been to protect against competitors free riding on the investment of time and resources spent onboarding, training, and acclimating a new employee. Employee retention and protecting an employer's "investment period" are major issues today, especially considering the high turnover in the post-pandemic labor market. Interestingly, in an Op-Ed published in the *New York Times* on January 9, Chairwoman Khan argues that a prohibition on non-competes would actually alleviate this problem by "allowing workers to freely match with the jobs that are right for them."

Whether the FTC's proposed rule could have that effect or not, employers may want to evaluate how their employee retention strategies would change without non-competes in their toolbox. Employers have an opportunity to be creative while building employee engagement and retention. Some employers now include hiring bonuses in their compensation packages, payable after a satisfactory employment period (one year, for example) but advanced to the employee upon hire. Employees who leave before the period can then be on the hook to repay the bonus if they leave early, which protects a company's investment in an employee by incentivizing a certain minimum tenure.

Take Stock of Current Non-Compete Provisions and Agreements

There's no better time for an employer to inventory and review which of its employees are subject to a non-compete than right now. Although this proposed rule is months—at the soonest—from being final, the FTC is not sitting idly in matters where particularly aggressive non-compete agreements have come to light. Just before presenting the proposed rule, the FTC announced that it had investigated and taken legal action against several companies for overly broad non-competes. Each of the actions was settled with a consent order, so the cases do not have any force as legal precedent. Nevertheless, they do indicate that the FTC as currently constituted will bring enforcement actions—whether or not the proposed rule is adopted—in circumstances where they consider the non-competes to have anticompetitive effects.

What kinds of cases might the FTC bring? One of the recently announced enforcement actions was against a Michigan-based security guard agency. The agency required all of its guards (who mostly earned "at or near minimum wage") to sign non-compete

provisions that prohibited the employees from working as security guards within 100 miles for two years after leaving the agency. The agreement also included a provision that required employees to pay \$100,000 for *each* violation of the agreement. The FTC consent order required the employer to release its employees from the agreements and banned the employer from enforcing non-compete provisions in any future ventures.

This example demonstrates that the FTC is poised to take action against employers with non-compete agreements that the agency deems aggressive, overly broad, or unnecessary, especially with respect to lower-wage employees. Employers should carefully consider the breadth and underlying purpose of current non-competes and ensure that the agreements are no more restrictive than necessary to protect the employer's legitimate business interests.

What Next? Much More to Come

Employers should expect much more to come on this front. Beyond the practical questions about how the FTC's proposed rule would operate, serious and legitimate concerns exist as to whether the FTC's rulemaking process is best suited to address non-competes, whether Section 5 gives the FTC authority to change the law in this way, or whether a ban of such provisions is a "major question" that is simply beyond the reach of a federal agency. While these questions are being resolved, it is important to remember that, as Chairwoman Khan recently argued, California (the world's fifth largest economy) has prohibited non-competes for more than a century without ruinous economic consequence. Nevertheless, the more that employers do to prepare for a potential blanket ban on non-competes, the easier future compliance will be.