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The FTC's Proposed Ban on Non-Compete Agreements

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Last month, the Federal Trade Commission ("FTC") announced a proposed rule that, if made final, would ban nearly all non-compete agreements in the United States as part of a broader initiative to promote fair competition in the labor markets. The FTC estimates that approximately 30 million U.S. workers are covered by non-compete agreements and that the proposed rule would increase wages by $300 billion per year. At a recent virtual public forum, some business leaders expressed concern that prohibiting non-compete agreements would eliminate a valuable tool in protecting company goodwill, particularly for executive or senior-level employees. While the proposed rule has caught the attention of employers and business owners, there is no need to panic just yet.

The Proposed Rule is Broad

To begin, the FTC's proposed rule is broad in scope. As drafted, the proposal would prohibit employers from imposing non-compete restrictions against workers, including employees, independent contractors, consultants, interns, and volunteers. Thus, the breadth of the proposed rule evidences the current policy of disfavoring a business's ability to enter into and enforce non-competes based on the FTC's initial finding that non-compete agreements constitute an "unfair method of competition."

This prohibition further extends to any agreements deemed to be "de facto" non-compete clauses, which cover agreements that do not expressly prohibit competitive activities but have the effect of prohibiting workers from seeking or accepting new employment or operating a business after the worker leaves their current employment. Thus, the proposed rule would extend to non-disclosure and non-solicitation agreements that are broad enough to have such a preclusive effect.

The proposed rule does provide a narrow exception in the context of the sale of a business and does not apply to non-competes entered into by a person selling all of their ownership interest in a business entity or selling all or substantially all of a business entity's assets. However, this exception only applies to persons having at least a 25% ownership interest in the business entity.

Not only does the proposed rule prohibit the imposition of new non-competes, but it also nullifies all existing non-competes and requires employers to inform workers (both current and former) that the non-competes are no longer in effect.

The Proposed Rule Evidences a Growing Trend

The FTC's proposed rule evidences a growing trend among usually more progressive jurisdictions to limit and restrict the applicability of non-compete agreements. Most states have enacted laws that restrict covenants not to compete.

In Texas, for example, a covenant not to compete must contain reasonable limitations as to time, geographical area, and scope of activity to be restrained. A covenant not to compete is a restraint of trade and is unenforceable as a matter of public policy unless it meets this reasonableness standard. Whether such a covenant is a reasonable restraint is a question of law for courts to decide.

On the other hand, California and Oklahoma have gone even further and enacted statutes that, for the most part, render non-compete provisions void. As with most rules, there are exceptions. For instance, California permits the use of non-compete provisions in limited circumstances whereby a person owns a partial interest in a business. Other states, such as Illinois, Colorado, and Washington, have enacted statutes therein rendering non-compete provisions void unless it is shown that the employee or independent contractor earned more than a threshold amount established by law. Likewise, in the state of Nevada, a covenant not to compete may not apply to an employee who is paid on an hourly wage basis—exclusive of any tips or gratuities. In other states, legislative bodies have been considering additional restrictions on non-compete agreements.

The proposed rule is currently open for public comment until March 20, 2023, and may be revised after the comment period. Once a final rule is published, it will not take effect for 180 days, and there will no doubt be substantial legal challenges. One Republican-appointed FTC Commissioner has already stated her intent to resign, citing the proposed rule as one of several examples of "willful disregard of congressionally imposed limits on agency jurisdiction" and "defiance of legal precedent." [1] While most legal commentators believe the rule will not survive in any form, let alone in the current proposed form, the proposal evidences the increasing hostility in many jurisdictions toward restrictive covenants for individual workers. Employers should take the opportunity to take stock of their use of restrictive covenants.

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[1] https://www.wsj.com/articles/why-im-resigning-from-the-ftc-commissioner-ftc-lina-khan-regulation-rule-violation-antitrust-339f115d

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