

## FTC Proposes Sweeping Rule to Ban Non-Compete Agreements

The Federal Trade Commission (“FTC”) published last week a proposed rule which would prohibit employers from entering into non-compete agreements with all workers—employees, independent contractors, volunteers and interns. The proposed rule would also mandate employers to rescind existing non-compete agreements. This proposed rule takes a sweeping approach to nullify the traditional fact-specific analysis for assessing the fairness of non-compete agreements, and to prohibit employers from using post-employment restrictive covenants to protect their valuable confidential information and trade secrets.

### Background

A non-compete agreement is an agreement between an employer and an employee wherein the employee promises not to compete with the employer for a period of time after the cessation of employment. There exists no federal law prohibiting or limiting an employer’s use of non-compete agreements and other restrictive covenants in employment contracts. Therefore, the enforceability of non-compete agreements has been a matter of state law.

In the vast majority of states, courts have employed fact-specific inquiries to determine whether non-compete agreements are reasonable. Common inquiries generally include whether the employer has a legitimate interest to protect, whether the geographic or temporal restriction is reasonable, and whether the employer provided additional compensation or benefits in exchange for the employee signing the non-compete. However, an increasing number of states have recently implemented more bright-line rules that specifically limit or altogether ban non-compete agreements.

In 2021, President Biden signed an Executive Order seeking to ban or limit businesses’ use of non-compete agreements and licensing requirements, in an effort to promote competition and innovation by small and large firms. The “Executive Order on Promoting Competition in the American Economy” called on federal agencies to use their authorities to advance the policies expressed in the Order, including specifically calling on the FTC to exercise its rulemaking authority to curtail the unfair use of non-compete clauses that unfairly limit worker mobility.

### FTC

Before examining the FTC’s proposed rule and its implications, it is important to review the FTC’s structure, mission and authority. The FTC is an independent regulatory agency with the overall objectives of protecting the public from deceptive or unfair business practices and from unfair methods of competition through law enforcement, advocacy,

research and education. The agency is composed of five Commissioners appointed by the President and confirmed by the Senate, each of whom serves a seven-year term. The FTC may not have more than three Commissioners belonging to the same political party.

The FTC is authorized to make rules and regulations to protect consumers and competition by addressing unfair methods of competition. The FTC cannot punish or fine violators, as such is the responsibility of the judicial system. But, it can issue cease-and-desist orders and pursue legal cases in federal and administrative courts. Every year the FTC brings hundreds of cases against individuals and companies for violating consumer protection and competition laws that the agency enforces.

## Proposed Rule

The FTC's proposed rule would prohibit an employer from (1) entering into, or attempting to enter into, a non-compete agreement with a worker, (2) maintaining a non-compete agreement with a worker, or (3) representing to a worker that the worker is subject to a non-compete without a good faith basis to believe that the worker is subject to an enforceable non-compete. As drafted, the proposed rule would require employers that maintain non-competes with their workers to rescind those agreements no later than 180 days after the final rule is published. The proposed rule's definition of "worker" encompasses employees, independent contractors, externs, interns, volunteers, apprentices, and even sole proprietors who provide a service to a client or customer.

The proposed rule explicitly states that it preempts state laws, regulations, orders, or interpretations to the extent they are inconsistent with the FTC's rule, unless the state law provides "greater protection" to workers. In other words, the FTC's proposed rule seeks to provide a "regulatory floor, not a ceiling."

## Proposed Rule's Definition of Non-Compete

Under the proposed rule, a "non-compete clause" is defined 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." The proposed rule also employs a "functional test" whereby a non-compete clause is "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," including (a) a nondisclosure agreement written so broadly as to effectively prevent the employee from engaging in competition, and (b) an agreement to repay training costs, if the required payment is not reasonably related to the actual costs incurred by the company for training the worker.

The proposed rule does not specifically ban non-solicitation agreements, which is a separate provision that prohibits a former employee from soliciting the company's customers or employees for a certain period of time after the employee's departure from the company. But, the proposed rule would seemingly apply to non-solicitation agreements, like non-disclosure agreements, that were written so broadly as to effectively prevent the employee from engaging in competition.

## Exception to the Proposed Rule

The proposed rule would allow non-compete agreements between the seller and buyer of a business. However, this exception applies only where the party restricted by the non-compete clause is an owner, member, or partner holding at least a 25% ownership interest in a business entity.

## Further Considerations

The proposed rule is open for public comment for a period of 60 days. The FTC can finalize the rule based on input received from the public. It is not clear how long the FTC would take to finalize the rule, should it choose to do so.

The proposed rule is expected to be met by considerable challenges from various groups, which could delay the process. No doubt that the FTC's authority to make such a sweeping rule will be called into question. The U.S. Chamber of Commerce has already released a statement voicing that the FTC's "outright ban [on] noncompete clauses in all employer contracts is blatantly unlawful. Since the [FTC's] creation over 100 years ago, Congress has never delegated the FTC anything close to the authority it would need to promulgate such a competition rule."

Hallett & Perrin will continue to monitor the situation and can be reached with any questions on non-compete agreements.

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