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Are Non-Compete Clauses A Thing Of The Past?

Analyzing the FTC's New Regulation Declaring Non-Compete Clauses An Unfair Method Of Competition

On July 9, 2021, President Biden issued an executive order that, among other things, directed the Federal Trade Commission (FTC) "to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility." Making good on (and, in fact, going significantly beyond) this directive, on Jan. 5, 2023, the FTC released its proposed regulation which declares most non-compete clauses, and other clauses which have the effect of prohibiting competition, an unfair method of competition. This proposed regulation has a wide-reaching impact and is analyzed more fully below.

The Regulation

The FTC's proposed regulation seeks to add a new subchapter J, consisting of part 910, to Title 16, Chapter 1 of the Code of Federal Regulations. Section 910.2(a) of the proposed regulation declares: "[i]t is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or represent to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause." The term "worker" applies to both employees and independent contractors.

Section 910.2(b) of the proposed regulation requires employers to rescind existing non-compete clauses with their employees (current or past) within 180 days after the regulation is formally published and subsequently provide each employee notice of such recission within 45 days after rescinding the noncompete clause. Section 910.2(b)(2)(C) provides model notice language for employers to give to their current or past employees subject to non-competition obligations.

Section 910.3 provides a narrow exception to the ban on non-compete clauses, which permits a person who is a "substantial owner of, or substantial partner in" a business to enter into a noncompete agreement where that person is "selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity, or ... selling all or substantially all of a business entity's operating assets."

Section 910.1(b)(1) 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." Section 910.1(b)(2) expands this definition to include "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." Such *de facto* non-compete clauses include a non-disclosure agreement "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"

and contractual terms "that require[] 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."

Section 910.4 of the proposed regulation purports to preempt state laws to the extent such state laws are inconsistent with the proposed regulation.

The Regulation's Potential Impact

The FTC's proposed regulation will have a wide-ranging impact on all manner of businesses, big and small, across all industries. The regulation, if adopted, unequivocally precludes classic non-compete clauses entered into as a condition of employment. In addition, the FTC's broad definition of non-compete clauses, which includes "*de facto*" non-compete clauses, creates the potential that broadly drafted non-disclosure, non-solicitation, anti-poaching and other types of restrictive covenants meant to protect trade secrets, confidential business information and/or the exploitation of customer relationships and goodwill could violate the FTC's proposed regulation and be effectively nullified.

As a result, should the FTC's proposed regulation go into effect, businesses will not only be prohibited from using non-competition clauses, but they must also carefully review (and, if necessary, revise) their employment and post-employment contracts to ensure that any non-disclosure, non-solicitation, anti-poaching monetary penalty clauses or other agreements intended to protect the business are narrowly tailored to avoid potential nullification through the FTC's proposed regulation.

Further, and regardless of whether the rule is finalized or challenged on rulemaking grounds, the legal position underlying the FTC's announcement creates additional risks to employers seeking to implement and enforce non-compete agreements.

The Future of the FTC's Proposed Regulation

Whether the FTC's proposed regulation will ultimately go into effect remains to be seen. Initially, the proposed regulation faces a 60-day public comment period, during which the public is invited to comment on the proposed regulation, which may or may not impact the final regulation. Comments on the proposed regulation may be made up to 60 days after the Federal Register publishes the proposed rule. The public comment period will open soon.

Following the public comment period, the FTC will take another vote on the final regulation before final publication of the regulation. The final vote has not yet been scheduled.

The FTC's proposed regulation is likely to generate significant and substantial litigation on various grounds, including, without limitation, that it exceeds executive authority and goes beyond the limited mandate of President Biden's Executive Order. Bond will, of course, provide updates if and when the FTC's rule is challenged on these and other legal grounds.

Conclusion

The future of non-compete clauses is murky. If the FTC's proposed regulation goes into effect, non-compete clauses as we know them will be a thing of the past. However, the FTC's proposed regulation will likely face many challenges in the weeks and months to come and may be tied up with legal challenges for the foreseeable future.

Should the FTC's proposed regulation go into effect, employers will need to take steps to comply with the regulation, including by reviewing their employment and post-employment agreements to identify whether they contain any non-compete clauses and, if so, rescind such clauses and provide the necessary notice to employees. In addition, employers should immediately consider, in anticipation of the regulation going into effect, having their non-disclosure, non-solicitation, anti-poaching and other types of agreements reviewed and, if necessary, revised, to better ensure they are no broader than necessary to protect against the use and disclosure of confidential and trade secret information or the exploitation of customer relationships and goodwill.

For any questions about this issue, please feel free to contact Bradley A. Hoppe, Kevin Cope, any attorney in Bond's litigation practice, labor and employment practice or the attorney at the firm with whom you are regularly in contact.

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