

Biden Administration Rings in the New Year with a Seismic Change: FTC Proposed Rule Would Ban Noncompetes Across the Country



Employment

January 10, 2023 | **CLIENT ALERTS**

Restrictive covenants, and more specifically, noncompete agreements, have been under increased scrutiny over the past several years. To date, restrictive covenants, including noncompetes, have been regulated at the state level and some states, such as California, have prohibited noncompete agreements in employment for many years. On January 5, 2023, President Biden's Federal Trade Commission started the new year on a bold note by announcing a [proposed rule](#) that would effectively ban noncompete agreements and retroactively void those currently in effect. The proposed rule is subject to a 60-day window for submission of public comments but, if enacted as written, would significantly impact tens of millions of workers who have signed agreements containing a noncompete provision.

Under the proposed rule, it would be an unfair method of competition for a business to enter into, or attempt to enter into, a noncompete agreement with a worker. The proposed rule would also prohibit employers from "maintain[ing]" with a worker a noncompete clause or representing to a worker that he or she is subject to a noncompete clause where the employer has no good faith basis to believe the worker is subject to an enforceable noncompete clause. As currently drafted, the rule applies not only to traditional employees but also includes

externs, interns, volunteers, and apprentices.

Quite significantly, the proposed rule goes beyond the employment relationship. The rule defines “employment” to include independent contractor relationships, among others. In addition, while the rule would not apply to a franchisee in the context of a franchisee-franchisor relationship, it does include a natural person who works for the franchisee or franchisor.

The rule also restricts some noncompete agreements arising in the sale of a business. As the proposed rule is currently drafted, noncompete agreements between a seller and a buyer of a business are invalid unless the party restricted is an owner, member or partner holding at least 25 percent ownership interest in the business entity.

The language of the proposed rule is drafted broadly to encompass almost all forms of noncompete agreements—including those that do not contain express terms related to non-competition but that may have similar effects. The term “noncompete agreement” is defined in the proposed rule 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 FTC plans to place greater emphasis on how such a contractual term functions, rather than how it is named. For example, the rule contains a “functional test” for whether a contractual term is a noncompete clause. As described in the proposed rule, a contractual term will be considered a noncompete (and thereby void) where 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. The rule specifically identifies the following types of contractual terms as a non-exclusive list of potential “noncompete clauses” for purposes of the proposed rule:

(i) a nondisclosure agreement between an employer and worker that is written broadly enough to effectively preclude the worker from working in the same field after the conclusion of the workers’ employment with the employer; or

(ii) a contractual term that requires a worker to pay the employer (or a third-party) training costs if the worker’s employment is terminated within a specified time period, provided that the required payment is not reasonably related to the costs the employer incurred for training the worker.

Upon finalization of the new rule, businesses will be required to engage in “individualized” communications with all workers and former workers (provided the business has a former workers’ contact information “readily available”) subject to noncompete clauses to inform each such worker or former worker that their noncompete clause is no longer in effect and may not be enforced. Notice must be provided within 45 days of rescinding the noncompete clause. The proposed rule contains model language businesses may use to comply with this notice obligation. However, the model notice includes a statement that noncompetes are an unfair method of competition and that a covered worker may not compete with the business at any time following the conclusion of employment—both of which arguably go beyond the requirements of the proposed rule. Businesses may opt to create their own notice in compliance with the regulations but without such dramatic statements.

Notably, the proposed rule does not appear to restrict noncompetes *during* a worker’s employment. The proposed rule also does not appear to prohibit nonsolicitation agreements unless they run afoul of the “functional test”.

Today, in the majority of states, should a worker violate a valid noncompete agreement, the business may bring a

breach of contract claim against the worker. A successful action can result in the worker owing the business monetary damages, being enjoined from working for a competitor in violation of the agreement, or both. Noncompete agreements are currently legal in 47 states.

The FTC's proposed rule would dramatically change the legal landscape surrounding restrictive covenant agreements and worker mobility. If finalized in its current form, businesses will no longer be able to enter into agreements that prohibit workers from competing with the business. Businesses who have noncompete agreements in effect at the time the proposed rule is finalized will have 180 days from the date the final rule is publicized to come into compliance.

This proposed rule will not affect businesses until the notice and comment period closes and the rule is finalized, likely with changes made following review of comments received. In addition, there is no doubt this proposed rule will be subject to legal challenges. The proposed rule takes discretion away from the individual states and broadly prohibits noncompete agreements at the federal level, seeking to supersede any inconsistent state statute, regulation, order or interpretation. Nonetheless, businesses who utilize noncompete agreements should still consider engaging in preliminary steps to come into compliance with the new rule. Businesses should review their restrictive covenant agreements and identify which agreements may contain potentially unlawful noncompete provisions. Businesses should also review their nondisclosure and nonsolicitation agreements for compliance with the proposed rule and to consider re-stating or revising them given the likely unenforceability of any corresponding noncompete provisions. Businesses will also need to carefully evaluate consideration issues (i.e. what the business is providing to the worker in return for the worker's agreement to a covenant), which appear to continue to be governed by state law. However, at the moment, businesses can continue to enforce noncompetes and include them in worker contracts, subject to compliance with the current applicable laws.

If you have any questions about the FTC's proposed rule or proactive steps to consider taking now, please contact [Amy Habib Rittling](#) (716.853.5100 x1276), [Michael Lufkin](#) (904.660.0020 X1562), [Andrew Drilling](#) (716.853.5100 x1253), [Brittany Mills](#) (904.660.0020 x1547) or any other member of our [Employment Practice team](#).

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