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# 2023 Future Leaders Seminar: Building Future Leaders

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## Free to Compete

*Exploring the Implications of the FTC's Proposed Rule Banning Non-Compete Agreements*


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## What is the Proposed Rule/What Can We Expect?

In January 2023, the Federal Trade Commission ("FTC") proposed implementing a rule that will ban most non-compete clauses for employment contracts nationwide (the "Proposed Rule"). Subject to limited exceptions, the Proposed Rule would not only ban prospective non-competes, but also retroactively nullify all non-compete agreements presently in place. Moreover, employers would be required to send notices to all current and former affected employees regarding the implementation of the Proposed Rule.

The public comment period, which ended in April, produced tens of thousands of comments that the FTC is deliberately wading through, taking steps to implement potential changes that would increase the odds of the Proposed Rule surviving inevitable litigation challenges. This comment-culling period delayed the Proposed Rule's implementation…for now. Yet, the waiting game has put employers in limbo, without a concrete timeline and without knowing how the final rule will ultimately look.

The FTC is taking a labor/employee-friendly stance on the grounds that non-compete agreements stifle competition, restrict labor mobility, suppress wages, and prevent companies from hiring the best talent for the right jobs. Employers, on the other hand, utilize non-competes to protect legitimate business interests and trade secrets, and to prevent attrition and turnover in their workforces, especially among highly skilled and specialized labor.

### What does the Proposed Rule Look Like?

In its preliminary form, the Proposed Rule would be a sweeping repudiation of non-competes in almost all circumstances. The Proposed Rule defines "non-compete clause" to mean a contractual term that blocks a worker from working for a competing employer, or starting a competing business, within a certain geographic area and period of time after the worker's employment ends.

After a limited commencement period following the enactment of the Proposed Rule, likely 60-180 days, the FTC will begin enforcement by first making a formal cease-and-desist complaint that would be handled by an administrative law judge in a trial-like proceeding. The FTC may seek an array of remedies in court including civil penalties, restitution, damages, injunctive relief, orders of rescission or reformation of contracts. The FTC may also make referrals to the U.S. Department of Justice for criminal prosecution.

From the FTC's website:

The FTC's Proposed Rule would generally prohibit employers from using non-compete clauses. Specifically, the FTC's new Rule would make it illegal for an employer to:

- enter into or attempt to enter into a non-compete with a worker;
- maintain a non-compete with a worker; or
- represent to a worker, under certain circumstances, that the worker is subject to a non-compete.

The Proposed Rule would apply to independent contractors and anyone who works for an employer, whether paid or unpaid. It would also require employers to rescind existing non-competes and actively inform workers that they are no longer in effect.

The Proposed Rule would generally not apply to other types of employment restrictions, like non-disclosure agreements. However, other types of employment restrictions could be subject to the rule if they are so broad in scope that they function as non-competes.

## What are the Exceptions?

The Proposed Rule will not apply to non-competes derived from a sale of a business, if the non-compete is applied to a substantial owner of, or a substantial member or substantial partner in, the business entity at the time the person enters into the non-compete clause.

The terms "substantial owner," "substantial member," and "substantial partner" are defined to mean an owner, member, or partner holding at least a 25% ownership interest in a business entity. The FTC's notice of the Proposed Rule notes that after the 60-day comment period, the FTC may elect to change the percentage of ownership interest for purposes of these definitions to a smaller or larger percentage.

The Proposed Rule also does not apply to other restrictive covenants, such as non-solicitation, confidentiality/NDA, or non-disparagement clauses. However, if employers attempt to draft and implement these clauses in a way that functionally acts as a non-compete, those actions would violate the Proposed Rule and subject the employer to potential liability.

# Business Implications

While the enforceability of non-competes is currently a matter of state law, the Proposed Rule will supersede all state laws concerning non-competes to the extent that they are inconsistent. As such, all employers across the United States should be aware of the potential implications that the Proposed Rule could have on its businesses. The Proposed Rule would not only prohibit employers from entering into non-competes with all employees, but it would also invalidate existing non-competes. As a result, employers will be forced to rescind those agreements and notify all current and former employees that they are no longer bound by them.

The Proposed Rule raises concerns among employers' protection of the business' intellectual property, trade secrets and other confidential information. Non-competes allow employers to have more security in knowing that the information they provide to their employees will not be used by a competitor. The ban on non-competes would not only allow employees to switch jobs at any time without any restrictions, but also potentially allow them to bring the proprietary and confidential information to a competitor. This is especially critical in industries that involve trade secrets with unprotected intellectual property.

If the Proposed Rule is implemented, it will likely face legal challenges concerning the FTC's authority to issue and enforce the rule. There is also no doubt that the Proposed Rule could create a rise in lawsuits concerning the disclosure of trade secrets and confidential information if other restrictive covenants are not put into place.

Ultimately, businesses should look into alternative means of protecting trade secrets, intellectual property and other confidential information. Other restrictive covenants like non-disclosure or non-solicit agreements should be considered as alternatives to non-competes in order to accomplish a similar goal. Businesses, however, should be aware that while the FTC has indicated that the Proposed Rule would not apply to other restrictive covenants, it has indicated that such restrictive covenants would be considered non-competes for the purposes of the Proposed Rule in scenarios that prevent a worker from working in the same field.

# Planning for Implementation of the Proposed Rule

During this waiting period, what should employers do to prepare for the FTC's implementation of the Proposed Rule?

## Create an Inventory of Current Restrictive Covenants

In order to seamlessly transition to a legal landscape in which the Proposed Rule is implemented, employers should begin creating an inventory of current restrictive covenants. Because the Proposed Rule will require employers to notify all current and former employees with an existing non-compete agreement, employers who already have an easy-to-utilize list of current restrictive covenants will be able to swiftly comply with the Proposed Rule. Further, such an inventory is helpful even if the Proposed Rule does not become law, as it can help employers track when each agreement expires.

## Review Existing Restrictive Covenants for Compliance

As mentioned above, although the Proposed Rule only invalidates non-compete agreements, the FTC has indicated its intent to apply the Proposed Rule to other restrictive covenants if they are so broad as to effectively restrict employees from competing in the same field. As such, employers should take this opportunity to review existing restrictive covenants for compliance with the Proposed Rule. Is your current non-disclosure or confidentiality agreement so broad that it effectively restricts former employees from working in the same industry? Does your non-solicit agreement prohibit former employees from competing in the same field? Employers should review such restrictive covenants for compliance with the Proposed Rule and determine whether a less burdensome covenant, one that complies with the Proposed Rule, would meet the same goals as the existing, non-compliant restrictive covenants.