



News & Types: Employment, Labor & Benefits Update

Masuda Funai Employment Newsflash: FTC Proposes Rule to Ban Non-Competes

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Practices: Employment, Labor & Benefits

On January 5, 2023, the Federal Trade Commission (FTC) issued a Notice of Proposed Rulemaking (NPRM) that, if adopted, would functionally serve as a complete ban on non-compete clauses and contractual provisions or employment policies that have a similar effect with limited exception.

Key Features of the Proposed Rule

Under the proposed rule, the FTC would deem non-competes between employers and workers “an unfair method of competition” and, therefore, unlawful under Section 5 of the FTC Act. The proposed rule prohibits 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 they are subject to a non-compete without a good faith basis to believe that the worker is subject to an enforceable non-compete. The proposed rule would supersede any inconsistent State law unless such law provides greater worker protections than those provided by the proposed rule.

Notably, the proposed rule goes beyond traditional non-competes. The rule would cover any provision that the FTC determines functions as a “de facto” non-compete. The proposed rule explains that a “de facto” non-compete clause is a contractual provision that has the effect of prohibiting a worker from seeking or accepting employment with another employer. The FTC provides two examples of such “de facto” non-competes: (1) a non-disclosure provision that is 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 (2) a contractual term that requires a worker to pay the employer for training cost if the worker’s employment is terminated within a specified period, where the required payment is not reasonably related to the costs the employer incurred for training the worker.

Moreover, the rule would cover agreements with any “worker,” defined as a natural person who works (whether paid or unpaid) for an employer and expressly includes those classified as employees, independent contractors, externs, interns, volunteers, apprentices, or sole proprietors who provide a service to a client or customer.

The proposed rule would prohibit employee non-competes both going forward and retroactively. Employers with preexisting non-competes would be required to rescind those agreements and inform employees and ex-employees that those agreements are no longer in effect.

Finally, the FTC notes that the proposed rule “would apply only to post-employment restraints — i.e., restrictions on what the worker may do after the conclusion of the worker’s employment with the employer.” Accordingly, “concurrent-employment restraints — i.e., restrictions on what the worker may do during the worker’s employment” — would not be impacted by the FTC’s regulation.

The sole limited exception to the proposed rule applies to individuals selling a business entity, ownership interest in a business entity, or all of a business entity’s operating assets where the individual restricted by a non-compete was a substantial owner, member, or partner in the business entity as they agreed to the non-compete.

Road Ahead

The FTC will begin accepting comments on the proposed rule after the NPRM is published in the Federal Register. Afterward, the FTC will accept public comments for a period of 60 days. Then, the FTC can finalize the rule based on input received from the public. As currently drafted, the FTC has indicated that it will provide employers a “compliance period” of 180 days from the date of publication of the final rule to comply.

We note that any finality of the rule is far from imminent as litigation challenges will likely seek injunctions to delay its implementation. However, employers cannot count on such court relief to delay their compliance obligations.

Employers that want to re-examine their existing non-compete agreements or who want to submit a public comment in response to the FTC’s proposed rule can contact Kevin S. Borozan or any member of Masuda Funai’s Employment, Labor and Benefits Group.