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Federal Trade Commission Proposes Rule to Ban Non-Compete Clauses

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The United States Federal Trade Commission (FTC) recently issued a proposed rule that, if adopted, would broadly prohibit employers from entering into post-employment non-compete agreements with workers, and would also require employers to rescind any such existing non-compete agreements. The proposed rule, released on January 5, 2023, provides that non-compete clauses with workers are an unfair method of competition. The proposed rule is expected to receive a substantial number of comments and face fierce legal opposition; therefore, any final rule (if adopted at all) may differ significantly from the proposed rule.

Summary of the Proposed Rule

The proposed rule would prohibit an employer from entering, or attempting to enter, into any contractual agreement that would prevent a 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 would apply to all employers and workers in the United States, with the term "worker" being defined broadly to include any employee, independent contractor, extern, intern, volunteer (whether paid or unpaid) or sole proprietor who provides a service to a client or customer; worker does not include a franchisee in the context of a franchisee-franchisor relationship, but it does include a natural person who works for the franchisee or franchisor. The proposed rule would not bar agreements that prohibit competition during the term of a worker's employment.

The proposed rule would cover not only conventional non-compete clauses that expressly prohibit employment or the operation of a business, but also de facto non-compete clauses or a non-disclosure agreement that is written so broadly as to effectively preclude the worker from working in the same field after the conclusion of the worker's employment, thus functioning as a non-compete agreement. In addition, the proposed rule would prohibit an employer from representing to a worker that the worker is subject to a non-compete clause when the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause.

The proposed rule would also require employers to rescind all existing non-compete clauses that fall within the scope of the proposed rule by no later than 180 days after the final rule is published and, within 45 days of rescinding the non-compete clause, to provide notice to each applicable worker that the worker's non-compete clause is no longer in effect. "Model language" of such notice is provided within the proposed rule and acts as a safe harbour for employers to comply with such notice requirement.

Any state law that is inconsistent with the proposed rule would be superseded by the proposed rule, except to the extent that the state law provides greater protection to workers than the proposed rule.

Sale of Business Exception

The proposed rule contains a limited exception for a non-compete clause entered into by a person who is selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity, or by a person who is selling all or substantially all of a business entity's operating assets, when the person restricted by the non-compete clause is an owner, member or partner holding at least a 25% ownership interest in the business entity.[1] Notably, there is no proposed exception for an owner who holds less than the 25% ownership threshold, notwithstanding that the owner may be receiving a significant purchase price. Because the proposed rule applies only to employers and workers, it would not prohibit a non-compete agreement in the context of a sale of a business by a person who is not a "worker," such as an institutional seller.

Looking Ahead

The proposed rule is subject to a 60-day public comment period beginning on the date it is published in the *Federal Register*, which is expected to occur soon. The FTC is specifically seeking comments, among other matters, on whether there should be a rebuttable presumption of unlawfulness instead of a categorical ban on non-competes and whether there should be exemptions or different standards for certain classes of workers, such as executives, high earners and/or learned professionals. The FTC has not provided a timeline for adopting a final rule, but it is widely believed that there will be a lengthy response period due to the large number of expected comments and that any final rule may not be published for a year or more. Any final rule that is adopted is proposed to become effective 60 days after it is published, and employers would be required to come into compliance with such final rule within 180 days of its publication.

For the time being, we suggest that employers monitor developments with respect to the proposed rule and, in preparation for adoption of any final rule, identify existing non-compete clauses that could be subject to this final rule. As noted above, any final rule, if adopted, could differ significantly from the proposed rule, and therefore we suggest that employers not make any changes to existing agreements at this time in connection with this proposed rule.

[1] The FTC believes that the 25% threshold is appropriate because it limits the exception to instances in which the seller's stake in the business is large enough that a non-compete clause may be necessary to protect the value of the business acquired. However, the FTC noted that it could set the threshold at a different percentage in the final rule or the final rule could simply reference a "substantial owner" and not include an ownership percentage threshold, in which case the interpretation would be left to case-by-case adjudication. Note that in certain situations the proposed rule could discourage a potential buyer from purchasing a business entity or have the effect of reducing the purchase price a buyer is willing to pay for a business entity. Situations could also arise where a seller would gladly agree to be subject to a non-compete if it meant receiving a higher purchase price (and there is no ability on a seller's part to waive the protection in exchange for the higher purchase price).

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