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Federal Trade Commission proposes a noncompete ban: Five things to know

By John David Gardiner

By now, most compliance professionals are aware of the Federal Trade Commission (FTC) press release from January 5,^[1] which announced its proposed rule to ban noncompete clauses.^[2] The FTC proposed adding a new subchapter J, consisting of Part 910, to Chapter 16 of the Code of Federal Regulations. The FTC invited public comment through March 20, 2023.

The FTC's proposed rule, if implemented, would prohibit employers from entering into or attempting 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." Employers would also be required to rescind any existing noncompete agreements by providing individual notice to anyone currently subject to a noncompete, including former employees.

The proposed rule defines a noncompete 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" but it also contains a functional test. According to the functional test, the FTC would deem any contractual term that has the effect of prohibiting a worker from seeking or accepting employment to be a noncompete clause. The FTC provides the following examples of terms that may be de facto noncompete clauses:

- A nondisclosure agreement between an employer and a worker 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.
- A contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time, where the required payment is not reasonably related to the costs the employer incurred for training the worker.

It is also important to note the FTC defines "worker" as anyone who works—paid or unpaid—for an employer. This would include unpaid interns and volunteers (who are rarely subject to noncompete agreements anyway), as well as independent contractors.

The proposed rule provides one exception. It does not apply to noncompete clauses that are entered into by individuals selling a business entity, otherwise disposing of all of their ownership interest in the entity, or selling all or substantially all of the entity's assets, so long as that person is "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.”

Noncompete agreements ripe for judicial review

The proposed rule would usurp states’ rights: “This Part 910 shall supersede any State statute, regulation, order, or interpretation to the extent that such statute, regulation, order, or interpretation is inconsistent with this Part 910. A State statute, regulation, order, or interpretation is not inconsistent with the provisions of this Part 910 if the protection such statute, regulation, order, or interpretation affords any worker is greater than the protection provided under this Part 910.” This is virtually certain to lead to judicial review and/or intervention and a likely tabling of implementation for federal circuit(s) for months and possibly years to come.

The FTC’s underlying rationale

On January 4, the FTC published a press release regarding legal action taken against three companies and two individuals to drop noncompete restrictions.^[3] “In its complaints, the FTC said the restrictions constituted an unfair method of competition under Section 5” of the Federal Trade Commission Act. Section 5 prohibits “unfair or deceptive acts or practices in or affecting commerce.”^[4] The prohibition applies to all persons engaged in commerce. In each case, the FTC has ordered the companies to cease enforcing, threatening to enforce, or imposing noncompete restrictions on relevant workers. They also are required to notify all affected employees that the noncompete restrictions no longer bind them.

Enforceability of a noncompete varies by state

California, North Dakota, and Oklahoma ban noncompete agreements with a few narrow exceptions. Colorado, Washington, DC, Illinois, Maine, Maryland, New Hampshire, Oregon, Virginia, and Washington state prohibit noncompete agreements unless the worker earns above a certain threshold. Massachusetts and Oregon have a “garden leave” statutory requirement: base pay for the duration of noncompete enforcement (at the former employer’s election). States that permit noncompete agreements have varying requirements.

FTC ban could take effect in Q3

The proposed rule was open for comments through March 20, 2023. If the proposed rule becomes final, employers will have 180 days to comply and 45 days to notify workers with existing noncompetes that those agreements are rescinded. The U.S. Chamber of Commerce, among others, has challenged the FTC’s authority to implement this broad rule, and legal challenges will likely follow. In the meantime, compliance professionals should determine the best strategy moving forward.

Review current noncompete agreements

Compliance professionals should review current noncompete agreements against state law and consider including a reference to the FTC’s proposal within new agreements for the here and now (i.e., 2023). For example, consider a clause in sum and substance that indicates: “This Agreement, including Paragraph ^, complies with any/all applicable state (e.g., Michigan’s Antitrust Reform Act; etc.) and federal laws. Should the Federal Trade Commission’s January 5, 2023, rule proposal to ban noncompete clauses become binding law, [Employer] will update and revise any/all Paragraph(s) of the Agreement (as applicable) in accordance with state and federal law and in conformance with Paragraph ^^ relating to Severability/Modification of this Agreement.”

For now, stay tuned, keep informed, and be compliant.

Takeaways

- Any federal noncompete prohibition—previously left to the states (with limited exceptions)—is ripe for judicial review and intervention.
- The Federal Trade Commission (FTC) gave insight into the underlying rationale for the proposed rule on January 4, 2023, with its press release regarding legal action against three companies and two individuals to eliminate noncompete restrictions.
- Currently, the enforceability or unenforceability of a noncompete agreement varies by state.
- The earliest the FTC ban could take effect is Q3 2023.
- Compliance professionals should review current noncompete agreements against state law and consider including a reference to the FTC’s proposal within new agreements for the here and now (i.e., 2023).

¹ Federal Trade Commission, “FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition,” news release, January 5, 2023, <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition>.

² Non-Compete Clause Rulemaking, 88 Fed. Reg. 3,482 (Jan. 19, 2023), <https://www.federalregister.gov/documents/2023/01/19/2023-00414/non-compete-clause-rule>.

³ Federal Trade Commission, “FTC Cracks Down on Companies That Impose Harmful Noncompete Restrictions on Thousands of Workers,” news release, January 4, 2023, <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-cracks-down-companies-impose-harmful-noncompete-restrictions-thousands-workers>.

⁴ 15 U.S.C. § 45.

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