

Federal Trade Commission Proposes to Invalidate Non-Compete Agreements

January 5, 2023

On January 5, 2023, the Federal Trade Commission ("FTC") issued a notice of proposed rulemaking that would render all non-compete agreements, other than those entered into in connection with the sale of a business, unlawful "unfair competition" under Section 5 of the Federal Trade Commission Act.

The proposed rule would forbid entry into, or maintenance of, any agreement which expressly prohibits an employee from working for another employer or operating an independent business after the conclusion of the existing employment. In addition, it would prohibit "de facto" non-compete agreements, which are defined as agreements which have the effect of precluding an employee from accepting or seeking alternate employment. The proposed rule cites as examples of "de facto" non-compete agreements overly broad non-disclosure agreements that effectively preclude work in the same field, and agreements that require an employee to repay training costs if they leave employment within a specified duration. The comments to the proposed rule suggest that typical non-solicitation clauses will not run afoul of the rule; however, the language of the proposed rule would leave overly broad non-solicitation agreements subject to challenge.

Because the proposed rule defines unfair competition to include "maintenance" of a non-compete or de facto non-compete agreement, it further requires rescission of existing non-compete agreements that would violate the proposed rule. Employers would be required to provide written notice of the rescission to all affected employees in a form prescribed by the FTC.

The only exception to the blanket ban on non-compete agreements is for those given in conjunction with the sale of a business by persons owning at least a 25% interest in the business being sold.

The proposed rule would preempt all inconsistent state laws unless they afforded greater protection to employees than the proposed rule.

If finally adopted, the rule would provide a defense against enforcement of non-compete agreements which violated the rule. In addition, because the proposed rule defines maintaining a non-compete agreement as a form of unfair competition, the entry into or failure to rescind an existing non-compete, even in the absence of attempted enforcement against an employee, could subject the employer to civil enforcement action and penalties by the FTC.

At this point in time, the rule is merely a proposal. Before it can go into effect there will be a 60-day notice and comment period, after which a notice of final rule must be published in the Federal Register. Should the proposed rule become final, it may be subject to legal challenge by parties opposing the rule.

Employers need not take any immediate action under the proposed rule, other than to consider providing comments to the FTC once the comment period opens. In addition, employers may want to start exploring methods of protecting intangible business assets through agreements other than non-competes. Even if the proposed rule never is enacted, many state legislatures and courts have shown growing disfavor of broad or onerous non-compete agreements where not essential to protect the employer.

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For further information, please call one of the listed authors or your Miller Canfield attorney.