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FTC's Proposed Rule Banning Employment-Based Non-competes

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On January 5, 2023, the Federal Trade Commission announced a new proposed rule that would, if adopted, ban the use of employment-based non-competes and require employers to rescind existing non-competes. Citing concerns that non-compete clauses reduce wages, stifle new ideas and hinder economic liberty, the FTC's proposed rule would reshape large segments of the American economy and supplant numerous recently enacted state statutes restricting the permissible use of non-competes and other restrictive covenants.

This rule proposal from the FTC comes amidst a push by the Biden administration to increase workers' ability to switch jobs and aggressively combat purported anticompetitive conduct by American businesses. Coming on the heels of changes last summer in the composition of the five-member Commission (currently comprising four members: three Democrats and one Republican), the FTC may take additional steps to address income inequality and tackle antitrust issues in labor markets.

The proposed rule would declare employment non-compete clauses "an unfair method of competition" utilizing an expansive interpretation of Section 5 of the Federal Trade Commission Act (FTC Act), 15 U.S.C. §§ 41-58, as amended, to preclude employers from entering into non-competes with workers, attempting to enter into such non-competes or representing to workers that a worker is subject to a non-compete. The proposed rule also would require employers to rescind existing non-competes executed prior to the rule's enactment within 180 days after publication of the FTC's final rule and to provide notice to each affected worker in an "individualized communication."

Of particular note is the scope of the FTC's proposed prohibition, which applies to **all** employment-based non-competes without any exception — e.g., for employees' compensation or management level. While the proposed rule does not explicitly ban non-solicitation clauses or non-disclosure clauses meant to protect confidential information or trade secrets, the FTC does propose a fact-specific inquiry to determine whether such contractual clauses between employers and workers are "*de facto* non-compete clauses" and has, on occasion, investigated those clauses claiming that such clauses were *de facto* non-compete agreements. The proposed rule even lists, as an example of a *de facto* non-compete clause, a non-disclosure agreement 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." The only non-competes the FTC's proposed rule would not prohibit are those entered into during the sale of a business if the person covered by the non-compete held at least a 25% ownership interest in the company at the time the non-compete was executed.

The FTC certainly will face challenges to its authority to enact such a rule. The fact sheet released by the FTC accompanying the proposed rule recognizes the transformative impact the rule would have on the American economy, noting that non-compete clauses "bind about one in five American workers" and estimating that "the proposed rule could increase workers' earnings across industries and job levels by $250 billion to $296 billion per year." Last year, however, the U.S. Supreme Court embraced the Major Questions Doctrine in *West Virginia v. EPA* and rejected agency claims of regulatory authority if a proposed rule concerns an issue of vast economic and political significance and Congress has not clearly empowered the agency regarding the issue. Assuming the FTC rule becomes final, courts will be asked to decide whether Congress, through the FTC Act, intended to delegate such sweeping authority to the FTC. The U.S. Chamber of Commerce, for example, has called the proposed role "blatantly unlawful" and is contemplating legal action.

What This Means for Employers

The FTC rule would have major implications for employers. If the proposed rule becomes effective, employers will need to consider alternatives to protect (1) customer and employee relationships and (2) confidential information.

With regard to customer and employee relationships, employers may consider entering into narrowly drawn customer and employee non-solicitation restrictive covenants with skilled labor or management employees that focus on the actual relationships that an employee developed while employed, which could provide sufficient protection. Other options include garden leave and fixed-term agreements.

With regard to confidential information, the FTC rule proposal acknowledges that its non-compete ban will create a gap in protection for employers seeking to protect their confidential information. One possible alternative that the

FTC identifies to fill this gap is trade secret laws. Indeed, the FTC points out that "[t]here is virtually no category of information that cannot, as long as the information is protected from disclosure to the public, constitute a trade secret."

For employers to protect their confidential information as a trade secret, however, they need to take reasonable steps to keep that information secret. *See, e.g.*, 18 U.S.C. § 1839. That means employers will want to consider, among other things, implementing or revisiting trade secret protection plans. This might include, for example, re-evaluating training, confidentiality policies, vendor agreements, physical security and IT restrictions to make sure the information is closely guarded and properly protected. Employers currently relying on restrictive covenants in employee agreements to protect their trade secrets should consult with an attorney to determine whether their policies and procedures are sufficient, and not beyond the scope of what can reasonably be claimed as a trade secret prior to the proposed rule going into effect.

Once the proposed rule is published in the *Federal Register*, the public will have 60 days to submit comments on the proposed rule, which the FTC will review and consider, to determine whether changes are needed. Employers should closely monitor the FTC's proposed rule as it progresses through the rulemaking process.

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