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FTC Proposes to Ban Employee Noncompete Agreements – January 31, 2023 Update

By Julie Levinson Werner, Zarema A. Jaramillo, Jonathan L. Lewis, and Jessica I. Kriegsfeld

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The Federal Trade Commission ("FTC") proposed a rule (the "Proposed Rule") that would prohibit companies from imposing post-employment noncompete agreements. If enacted, the Proposed Rule would bar employers from entering into noncompete agreements with employees, independent contractors, and unpaid workers, and would require employers to repeal or nullify any existing restrictions within six months of the Proposed Rule's effective date. The Proposed Rule would permit noncompete agreements in connection with the sale of a business, but only where the party restricted by the non-compete clause is an owner, member, or partner holding at least a 25 percent ownership interest in a business entity.

In explaining the basis for the proposed rule, FTC officials have said that non-competes do more harm than good. But the FTC is not just focused on non-competes. The FTC is intent on banning any agreement that that effectively limits an employee's mobility in a similar way as a non-compete agreement.

The Proposed Rule would not prohibit non-disclosure agreements ("NDAs") or customer non-solicitation agreements because, as the FTC has explained, "these covenants generally do not 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 FTC did comment that non-disclosure agreements and trade secrets laws can effectively protect the interests of businesses in lieu of non-competes and can serve as alternatives to non-competes permitted under the Rule, unless they are so prohibitive that they would be viewed as de facto non-competes.

Given prior actions by the Biden Administration, this action by the FTC is not surprising (except perhaps the breadth of prohibition). As we mentioned in our previous article, President Biden issued an Executive Order in July 2021 that made clear his administration would be scrutinizing noncompete agreements and encouraging the FTC to ban or substantially limit them. Also, both the FTC and the Department of Justice recently have been focusing on labor-related conduct, and have been investigating and even bringing enforcement actions against agreements and consolidations that allegedly restrain competition in labor markets.

In addition to the Proposed Rule, the FTC announced that it has reached settlements with three large companies to release employees from what the FTC called unfair noncompete agreements, further demonstrating the FTC's increased scrutiny of noncompete agreements.

Similar to the action at the federal level, many states have taken steps in recent years to restrict or limit the enforceability of employment noncompetes. Multiple states now require that a job applicant receive a noncompete at least 14 days prior to their start date. Colorado now requires an employee to be paid over $100,000, the District of Columbia has a $150,000 annual salary threshold, and Illinois requires an employee be paid at least $75,000 per year to be subject to a noncompete. States such as Maine, Massachusetts, Maryland, Virginia and Washington, DC prohibit noncompetes for hourly workers. In one way or another, almost half of the states restrict the ability of employers to enforce noncompete agreements against employees. And for many years, states like California, Oklahoma, and North Dakota have deemed employment noncompete agreements largely unenforceable.

The FTC is looking for interested parties to submit comments on the Proposed Rule. In fact, the FTC asks for comments on a number of alternatives to the Proposed Rule, including (1) whether the Proposed Rule should impose a categorical ban on non-compete clauses or a rebuttable presumption

of unlawfulness, and (2) whether the Proposed Rule should apply uniformly to all workers or whether there should be exemptions or different standards for different categories of workers (for example, senior executives versus lower wage employees). (Comments to the Proposed Rule are being accepted until March 20, 2023, and whatever rule is ultimately finalized will take effect 180 after the final rule is published in the Federal Register.)

No matter what rule the FTC ultimately adopts, legal challenges are sure to follow. Most notably, in dissenting from the decision to issue the Proposed Rule, Commissioner Wilson stated that the Proposed Rule "represents a radical departure from hundreds of years of legal precedent that employs a fact-specific inquiry into whether a non-compete clause is unreasonable in duration and scope, given the business justification for the restriction." Commissioner Wilson predicted that the Proposed Rule "will not withstand these challenges" outlining "numerous paths for opponents to challenge the Commission's authority to promulgate."

All of this is occurring against the backdrop of heighten antitrust enforcement in the labor and employment field. HR professionals must also remember that, in October 2016, the FTC and the Department of Justice Antitrust Division (the "Division") jointly issued their "Antitrust Guidance for Human Resource Professionals." There, the agencies gave notice that the Division would "proceed criminally against naked wage fixing or no-poaching agreements." Agreeing with individual(s) at another company about employee salary or other terms of compensation, either at a specific level or within a range (socalled wage-fixing agreements, or agreeing with individual(s) at another company to refuse to solicit or hire that other company's employees (so-called "no poaching" agreements), may result in criminal prosecution.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

JULIE LEVINSON WERNER
Partner, Employment Counseling & Litigation
T: 212.419.5864 / 973.597.2550
jwerner@lowenstein.com

ZAREMA A. JARAMILLO
Partner, Antitrust/Competition
Managing Partner, Washington, D.C.
T: 202.753.3830
zjaramillo@lowenstein.com

JONATHAN L. LEWIS
Partner, Antitrust/Competition
T: 202.753.3824
jlewis@lowenstein.com

JESSICA I. KRIEGSFELD
Associate
T: 212.419.6068
jkriegsfeld@lowenstein.com