FTC Proposes Complete Ban on Non-Competes

January 13, 2023

INSIGHTS

The Situation: On January 5, 2023, the Federal Trade Commission ("FTC") published a Notice of Proposed Rulemaking that would prohibit employers from entering into or maintaining non-compete clauses with any worker, with very limited exceptions. If promulgated, the proposed rule would preempt the current patchwork of state-law approaches to non-competes, except to the extent states provide greater protection to workers. While it is uncertain whether the proposed rule will be promulgated in its current form or whether it can withstand legal challenges, businesses should prepare for a significant shift in the enforceability of non-compete clauses and strengthen other tools to protect their competitive interests.

Planning Ahead:

- The proposed rule would require employers to rescind current non-competes with workers and prohibit employers from entering into non-competes with workers in the future.
- The FTC has also signaled it will scrutinize other commonly used restrictive covenants, which businesses should evaluate now for compliance under the standard set out in the proposed rule.
- Businesses should identify other methods to protect their trade secret and other competitive interests, including evaluating strategies for identifying and securing confidential information, trade secrets, and other intellectual property assets, and evaluating alternatives like garden leave and notice requirements for senior-level employees.
- Public comments to the proposed rule are due March 10, 2023, and the FTC has expressly invited comment on a number of significant issues. Businesses with strong opinions should consider submitting a comment.

OVERVIEW

Non-compete agreements have been under increasing attack at both the state and federal levels in recent years. Many states have adopted laws that restrict the use of non-competes for different types of workers, including outright bans and bans below certain threshold income levels. Interestingly, Georgia stands in contrast to this trend, as its Restrictive Covenants Act, which became effective in 2011, made it easier to enforce non-competes and other restrictive covenants with employees. But all this would change if the FTC's proposed rule becomes effective. Businesses in Georgia and elsewhere that use non-competes and other restrictive covenants to protect their competitive interests should note that the FTC's rule would preempt most states' laws and should closely monitor the proposed rule and any developments on its path towards final promulgation.

The Proposed Rule

The FTC's January 5 proposed rule would create a nearly complete nationwide ban on the use of non-competes, categorically deeming such provisions an unfair method of competition. The ban would apply broadly to the use of non-competes with any "worker," a term defined to include both employees as well as independent contractors, externs, interns, volunteers, apprentices, or sole proprietors who provide a service to a client or customer. The proposed rule would not apply to franchisees in the context of a franchisee-franchisor relationship, although such non-competes would remain subject to antitrust and other applicable laws. The rule would also contain an exception for non-competes in the context of the sale of a business as to an owner, member, or partner owning at least a 25% interest in the business.

Under the proposed rule, employers would be required to rescind any existing non-competes with current and former workers within 180 days after publication of the final rule. Within 45 days of rescinding the provision, employers would need to notify individually all existing workers and any former workers for whom the employer has contact information that the worker's non-compete has been rescinded. The proposed rule provides model language, though not required language, for such notices to workers. If the rule is enacted, employers should consider expanding the model notice to advise workers more specifically about other contractual restrictions they may still be subject to in order to reinforce those valid post-term restraints.

The proposed rule would not expressly prohibit the use of other types of restrictive covenants, including non-solicitation, non-recruitment, and non-disclosure agreements, but overly broad provisions could be deemed *de facto* non-competes in violation of the rule. The FTC has proposed a "functional test" to determine whether clauses other than non-competes nevertheless have the "effect of prohibiting 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." The FTC appears particularly focused on non-disclosure provisions that define the information the worker will be prohibited from using so broadly as to exceed legitimate confidential business information or trade secrets and effectively prevent a person from working for a competitor (for instance, non-disclosures that cover information "usable in" or that "relates to" the company's industry).

The FTC may modify the rule during the rulemaking process. The public comment period remains open until March 10, 2023. Chair Lina M. Khan, in a statement published on January 5, particularly invited public comment on three issues: (1) whether senior executives and other highly compensated workers should be subject to a different standard under the rule; (2) whether the rule should apply to non-competes between franchisors and franchisees, which currently are expressly excluded from the rule's scope; and (3) whether legal alternatives, including trade secret law and non-disclosure agreements, are adequate to protect employers' investments and interests.

These pointed questions signal that we could see significant changes to the text of the rule before a final rule is published. If the proposed rule is promulgated in any form, moreover, commentators anticipate significant legal challenges as to whether promulgating the rule is outside the FTC's rule-making authority or improper under the major-questions doctrine discussed in *West Virginia v. EPA*.

Take-Aways

Nevertheless, businesses can and should take steps now to be well-positioned to comply with any final rule that would gut all or most non-competes in employment agreements, while still protecting their competitive interests:

1. **Review other covenants.** Businesses should review other covenants used in their employment agreements in light of the FTC's concern for *de facto* non-competes. Overly broad non-disclosure, non-solicit, and non-recruit restrictions are likely to come under close scrutiny with the FTC. These provisions should be tailored to protect the business's legitimate proprietary interests and investment, and should not have the effect of precluding the worker from finding subsequent work in the same field. Businesses should consult knowledgeable counsel (inside or outside) to evaluate other covenants to be ready for a new standard.

2. **Secure sensitive information.** Businesses should evaluate their off-boarding practices to ensure that sensitive company information is not leaving the business with the separating worker. Exit interviews are a valuable tool to remind workers of applicable restrictive covenants and to ensure all devices, electronic files, and other company materials are returned to the employer. Businesses should understand what projects the departing employee was working on in the weeks or months before separation. That way, businesses can take stock of what sensitive information the worker may have used or had access to and tailor reminders to workers as to restrictions on their use or retention of specific trade secrets or confidential information.

3. **Focus on trade secret protections.** Now is a great time for businesses to evaluate their trade secret identification and protection measures and to develop a trade secret litigation preparedness plan. Federal and state laws provide robust trade secret protections to prevent unfair competition when workers leave to work for or become a competitor. Businesses should audit their important trade secrets and make sure that appropriate access restrictions are in place limiting access to trade secret information to those workers who truly need it. Company networks and returned devices should be scanned for signs of trade secret theft, including connection of unauthorized external storage drives or otherwise irregular downloads or uploads of competitive information. The early detection and identification of trade secret misappropriation can be critical to obtaining relief under applicable trade secrets laws.

4. **Consider alternative contract provisions.** Absent the availability of non-competes for senior executives and other highly compensated workers, businesses should consider alternative methods to protect the company's competitive interests upon their departure. Enforcing notice requirements or offering garden leave may be options to prevent unfair competition when senior-level workers leave the business.

5. **Submit comments to the FTC.** Lastly, businesses with strong opinions about the proposed rule should submit comments by March 10, 2023. Public comments can guide amendments to narrow or modify the rule before a final rule is published.

If your business would like assistance in submitting a comment or in assessing alternative methods to protect proprietary information and limit unfair competition, including evaluation of other covenants used in employment agreements and the scope and availability of trade secret protection, please contact Ron Coleman or Anne Baroody.

AUTHORS

Ron Coleman is an accomplished trial lawyer who thrives in big, complex cases. Throughout his 30-year career, Ron has helped his clients successfully resolve all manner of legal disputes, whether via negotiation, motion practice, alternative dispute resolution, trial, or appeal.

Ron T. Coleman, Jr.

Partner
Atlanta
404.420.1144
rcoleman@phrd.com

Anne is an associate in the firm's Litigation practice group. She focuses on complex commercial disputes and litigation before federal and state courts, the United States Trademark Trial and Appeal Board, and alternative dispute resolution bodies.

Anne H. Baroody

Associate
Atlanta
404.420.4326
abaroody@phrd.com