# Proposed rule banning noncompetes: taking stock as comments flood the FTC

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In what has been considered an extremely aggressive maneuver, the Federal Trade Commission earlier this year issued a proposed rule that would ban virtually any noncompete agreement (Non-compete Clause Rule ("Proposed Rule"), 88 Fed. Reg. 3482 (Jan. 19, 2023), http://bit.ly/4242hP7).

According to the FTC, noncompetes exploit workers, significantly reduce wages, stifle new businesses and ideas, and hinder economic liberty for approximately 30 million American workers. The FTC maintains that employers have less harmful tools at their disposal to protect trade secrets and other business interests than noncompetes, and concluded that these agreements represent an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act. 15 U.S.C. § 45(a)(1).

An avalanche of comments during the Proposed Rule's notice period followed. On Feb. 16, 2023, the FTC held an online forum inviting public discussion of the Proposed Rule. This article addresses the major takeaways from this discussion and the thousands of comments presented during the public comment period, in addition to providing background information about the Proposed Rule, identifying potential legal challenges, and providing thoughts on what employers should do next.

## FTC's proposed rule

In contrast to the FTC's sweeping approach, state law currently governs the enforcement of noncompetes. All 50 states impose some degree of limitations on noncompetes, or ban them entirely. If adopted, the Proposed Rule effectively would remove states from the enforcement apparatus altogether. (NPRM, 88 Fed. Reg. 3482, 3536, to be codified at 16 C.F.R § 910.4).

The Proposed Rule's key provisions center around the prohibition of all future noncompetes. (NPRM, 88 Fed. Reg. 3482, 3535, to be codified at 16 C.F.R. § 910.2(a)). The Proposed Rule also would rescind existing noncompetes between current and former workers and require that employers send notices to workers informing them that their current or past noncompetes are no longer binding. (NPRM, 88 Fed. Reg. 3482, 3535, to be codified at 16 C.F.R. § 910.2(b)).

The Proposed Rule broadly defines both workers *and* noncompetes. Workers are anyone who works – paid or unpaid – for an employer; this includes (but is not limited to) an employee, independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer. (NPRM, 88 Fed. Reg. 3482, 3535, to be codified at 16 C.F.R. § 910.1(f)).

Noncompetes are defined as contractual terms that prevent "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." (NPRM, 88 Fed. Reg. 3482, 3535, to be codified at 16 C.F.R. § 910.1(b)(1)).

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The Proposed Rule extends to other restrictive agreements such as nondisclosure agreements if they are "*de facto*" noncompetes. (NPRM, 88 Fed. Reg. 3482, 3535, to be codified at 16 C.F.R. § 910.1(b)(2)). And there are few exceptions, such as certain sales of businesses. (NPRM, 88 Fed. Reg. 3482, 3535, to be codified at 16 C.F.R. § 910.3).

## Extensive and sharply divided commentary on the proposed rule

Public comment during the 60-day notice period reveals opinion is sharply divided. The scope of the Proposed Rule has transformed the notice period into a sort of call to arms for stakeholders. More than 5,300 comments were posted ahead of the online forum, and the surge of opinions continued during the forum itself and in the ensuing weeks.

As of March 7, 2023, there were more than 8,800 comments posted on the FTC's rulemaking docket. That number will continue to grow following the recent FTC announcement extending the public comment period to April 19, 2023.

Comments during the online forum favoring adoption of the Proposed Rule were met in virtually equal measure with comments in opposition. Doctors, nurses, lawyers, CEOs, and an array of special interest groups such as the U.S. Chamber of Commerce, the National Retail Federation, and the Economic Security Project, marshaled arguments for and against the Proposed Rule. Others favored more streamlined changes to the Proposed Rule, such as narrowing the scope of the ban to only certain workers, eliminating retroactive prohibitions, and broadening exceptions.

Those in favor of the Proposed Rule insist noncompetes disproportionately harm workers across industries and job levels by restricting workers' freedom of movement and constraining competition. Workers with years of expertise arguably would be prevented from finding comparable work for the duration of their noncompete.

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For example, one panel member at the forum described the consequences of noncompetes that he and his family faced. According to this individual, he and his spouse spent a decade working as caretakers for the building where they lived, and as part of their compensation they were supplied an apartment. The couple were subject to a noncompete — signed when they first began working for the company — which prevented them from taking a job with another company in the same industry for one year. He described the toll of how in one day he lost both a job and a home — *and* could not accept a new job using his developed skills.

Proponents of the Proposed Rule may acknowledge the legitimate need for a business to protect confidential information, but contend that there are less harmful tools available to protect those interests. These methods could include nondisclosure, nonsolicitation or confidentiality agreements, enforcing patent and intellectual property laws, and invoking laws already on the books protecting trade secrets.

On the other hand, those opposed to the Proposed Rule argue that a business has a reasonable interest in restricting the dissemination of ideas to a competitor, and that alternatives to a noncompete are insufficient because they largely rely on seeking relief *after* information already has been disclosed.

To that end, one panel member urged the FTC to reconsider its broad prohibition on noncompetes in part by proffering the following example. Suppose an employer's chief scientist works for years developing a product before leaving to join a competitor. This scientist — in the absence of a noncompete — cannot help but use or rely upon the confidential information learned from their earlier employer to the benefit of the new one. The chief scientist would likely not need to rerun failed experiments or pursue discarded hypotheses. Noncompetes thus arguably serve the interests of business by protecting the cache of information collected through individual experience.

Some opponents have acknowledged that certain changes to the way in which noncompetes are used may be acceptable, but that the blanket ban goes too far. Instead, they suggest narrowing the scope of the Proposed Rule's focus and broadening exceptions to strike a balance that protects lower wage workers while targeting senior level workers with critical institutional and product-related insights, such as those occupying C-Suites or sensitive research and development roles within a business.

## What's next?

Even if the public comment period results in a narrowing of the Proposed Rule, it is likely that any form of restrictions on noncompetes by the FTC will face legal challenges. Indeed, although the online forum sought public comment as to whether the FTC *should* adopt the Proposed Rule, many participants sought to reframe the question as whether the FTC *can* adopt it.

Legal challenges may include whether the FTC's authority extends to regulating noncompetes as alleged unfair methods of competition under the Federal Trade Commission Act. Another likely issue is the breadth of preemption. States have traditionally regulated enforcement of noncompetes, but any state laws, regulations, or orders that are inconsistent with the federal rule would be superseded by the Proposed Rule in its current form. The Proposed Rule also could be challenged as impermissible legislative rulemaking.

## Employers should prepare now

Although it is unclear how the Proposed Rule will ultimately shake out, employers should begin taking steps to prepare now.

First, with an uncertain legal landscape, employers should consider other means of protecting interests short of noncompetes in existing and future employment agreements and contracts. These means include nondisclosure agreements and/or confidentiality agreements as well as nonsolicitation clauses. Drafted properly, such agreements may further employers' interests without as much legal risk.

Employers also should "double-down" on their confidentiality, intellectual property, and other similar policies. Companies should ensure they have clear policies on these issues, including the use — and misuse — of company property and technology, and they should be prepared to take swift action when their departing employees attempt to exploit such information at a new (or their own) business.

Finally, employers should consider the prospect that the complete ban in the Proposed Rule evolves into a more limited or targeted ban once the dust settles and the Rule is finalized. Should that happen, employers likely will need to be prepared to justify – if the FTC eventually comes calling – why noncompetes are necessary and defensible for their affected workers.

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