

Federal Trade Commission Seeks to Ban Non-Compete Clauses in Employment Agreements, by Keith Gutstein, Matthew Cohen and Taylor Ferris, 2-23-2023

The Federal Trade Commission (“FTC”) recently issued a Notice of Proposed Rulemaking in which the FTC proposed a new rule that would effectively ban non-compete clauses. If finalized, the proposed rule would supersede state laws and change the landscape of employment agreements as we know it. This proposal came just a day after the FTC took action against several companies and individuals asserting that their non-compete clauses are unfair.

The enforceability of non-compete clauses has typically been determined by state common law. Generally, non-compete clauses have been determined to be enforceable to the extent that the clauses are reasonable in time period and geographic scope and that they are necessary to protect the employer’s legitimate interests. However, under the proposed rule, employers would be barred from entering into almost all non-compete clauses that prevent workers from seeking or accepting employment or operating a business after the conclusion of the worker’s employment with the employer.

Specifically, the proposed rule provides, “[i]t is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or represent to a worker that the worker is subject to non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause.” Based on the broad definition of “worker,” the proposed rule would apply to employees, independent contractors, interns, and volunteers.

This ban would extend to *de facto non-compete clauses and provides a “functional test” to determine whether a contractual term is a non-compete clause. Pursuant to the language of the proposed rule, contractual terms that have an “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 proposed rule provides examples such as 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.”*

The proposed rule would not only prevent employers from entering into non-complete clauses with workers, but it would also require employers to rescind existing non-compete clauses. If the proposed rule is adopted, employers will be required to provide notice to current and former workers within 45 days of rescinding the existing non-compete clause. The proposed rule does provide model language for employers, but employers are not required to use this specific language, provided that the notice “communicates to the worker that the worker’s non-compete clause is no longer in effect and may not be enforced against the worker.”

Certain employers, such as banks, common carriers, and air carriers, are excluded under this proposed rule. Additionally, the proposed rule does provide a narrow exception upon the sale of a business or a partner or member’s ownership interest. The exception requires that the partner or member would have to have at least a twenty-five percent interest in the business. Notably, the proposed rule does not provide guidance as to how the ownership interest is determined.

Although the proposed rule has raised concerns amongst employers, the proposed rule is only at the early stages of the approval process. The proposed rule is open for public comment until at least May 10, 2023. Thereafter, the FTC could reopen the comment period, issue a new proposed rule, terminate the proposed rule, or move on the final rule. This process can and will take time.

As it stands now, there is no national ban on non-compete clauses. The enforceability of such clauses is governed by the state. For example, according to the New York State Attorney General, to be enforceable, a non-compete provision must: (i) be “necessary to protect the employer’s legitimate interests;” (ii) “not impose an undue hardship on the employee;” (iii) “not harm the public;” and (iv) be “reasonable in time period and geographic scope.” Until and unless the national ban is implemented, employers should comply with their respective state requirements to ensure their contractual provisions are enforceable.

KAUFMAN DOLOWICH IS HERE TO HELP

Kaufman Dolowich remains available to assist clients with the preparation of non-compete clauses. If you have questions about these developments, complying with your state’s common law, or are in need of assistance in implementing non-compete clauses, please contact one of the experienced employment attorneys at Kaufman Dolowich.

Keith J. Gutstein
Co-Managing Partner, KD’s Long Island Office
Co-Chair, Labor & Employment Practice Group

(516) 283-8708
kgutstein@kaufmandolowich.com

Matthew Cohen
Partner
(516) 283-8754
mcohen@kaufmandolowich.com

Taylor M. Ferris
Associate
(516) 283-8706
tferris@kaufmandolowich.com