

Federal Trade Commission Proposes Ban on Non-Compete Clauses

On January 5, 2023, the U.S. Federal Trade Commission (“FTC”) released notice of proposed rulemaking banning non-compete clauses for all workers with limited exception. While the rule is subject to public comment and review prior to implementation and likely will be subject to challenge, if adopted as proposed, the rule will have significant effects on employers across the country who impose non-competition covenants on their workforce.

The Proposed Rule

The FTC’s proposed Non-Compete Clause Rule (the “Proposed Rule”) banning non-compete clauses makes it an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker, maintain a non-compete clause with a worker, or represent to a worker that the worker is subject to a non-compete clause.

“Non-compete clause” is defined as a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker’s employment. The FTC commentary emphasizes that a provision will not be considered exempt from the definition of non-compete clause just because it is called a different name if it functions as a restriction on competition in the manner described above. Thus, certain customer or client non-solicitation covenants could be considered subject to the Proposed Rule if it is determined that such provision, in essence, functions as a non-compete clause.

The Proposed Rule applies to all employers subject to FTC jurisdiction, which covers the majority of employers. Entities that are not subject to FTC jurisdiction include certain banks, savings and loan institutions, federal credit unions, common carriers, air carriers and foreign air carriers, and an entity that is not “organized to carry on business for its own profit or that of its members,” such as a not-for-profit organization.

Similarly, the Proposed Rule applies broadly to all workers, whether paid or unpaid, including employees, independent contractors, externs, interns, volunteers, apprentices, or sole proprietors.

Effect on Existing Non-Competes

In addition to banning prospective non-competes, the Proposed Rule also invalidates existing non-competes and requires employers to inform current and former workers that those non-competes are void. The Proposed Rule includes safe harbor model language that satisfies a notice requirement to current and former workers that they are no longer subject to non-compete clauses. Currently, the Proposed Rule sets a 180-day compliance period from the date of publication of a final rule for employers to rescind existing non-competes.

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Limited Exceptions

The Proposed Rule contains a limited exception for non-compete clauses between buyers and sellers of a business where the restricted party is an owner, member, or partner holding at least 25% ownership interest in a business entity. The FTC's reasoning behind the 25% ownership threshold confirms its desire to reserve non-compete clauses only for parties who own a substantial portion of the business entity.

In addition, the Proposed Rule does not cover non-compete clauses between franchisors and franchisees.

Recommendations For Employers

While the Proposed Rule may be revised or rescinded following the public commentary period and subject to challenge if and when finally issued, the FTC has signaled its intent to scrutinize non-compete clauses that restrict workers. In addition, many states already have taken steps to restrict the use of non-compete clauses (e.g., California, Massachusetts, Maryland, Oregon).

While the Proposed Rule is pending, employers should ensure that any non-compete clauses comply with applicable state law and begin considering the potential impact if the Proposed Rule becomes effective. Additionally, employers may want to begin to explore alternatives to non-compete clauses, such as non-disclosure, non-solicitation clauses or garden leave provisions, that help companies protect their competitive information and relationships.

Please contact an attorney in MSF's Employment Group if you need assistance with respect to this information.



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