HR Insights

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Employer Takeaways From the FTC's Proposed Ban on Noncompete Agreements

The Federal Trade Commission (FTC) recently published a proposed rule that would ban noncompete clauses in employment agreements. According to the agency, if the proposed rule becomes final, it could increase employee wages by approximately $300 billion per year and expand career opportunities for 30 million American workers. This rule change would alter existing laws and significantly impact the employment landscape, so its critical employers understand the proposed rule and how it might impact them.

This article explains the FTC's proposed rule and details what employers should know about it.

Overview of the Proposed Rule

Under the proposed rule, noncompete agreements would be considered an unfair method of competition. If adopted, the FTC's rule would:

- Ban employers from entering into noncompete clauses with workers and independent contractors
- Require employers to rescind existing noncompete clauses with employees
- Require employers to actively inform their employees that their noncompete agreements are no longer in effect

The agency's proposed rule includes a limited exception for noncompete clauses between a seller and buyer of a business. Additionally, nondisclosure and nonsolicitation agreements are excluded from the definition of a noncompete clause.

The proposed rule would apply to both employees and independent contractors. If the rule becomes final, employers would be required to rescind existing noncompete clauses and notify employees who have been subject to these clauses of the rescission in writing within 45 days of the rule's implementation. As currently drafted, the FTC's rule would become effective 60 days after the final rule is published in the Federal Register, and employers would have to comply with the new rule within 180 days of its publication.

Rationale for the Proposed Rule

The FTC's proposed rule is based on President Joe Biden's 2021 Executive Order on Promoting Competition in the American Economy. This order encouraged the agency to exercise its statutory rule-making authority under the Federal Trade Commission Act (FTCA) to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility." In making its historic announcement, the FTC stated that noncompete agreements harm competition; suppress wages for workers, including those not subjected to noncompete clauses; reduce labor mobility; and hamper innovation. According to the agency, banning noncompete clauses would narrow pay gaps for groups of workers, such as women and minorities, by 4% to 9%.

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Potential Impact on Employers

The proposed ban would apply to every employer in the United States who has noncompete clauses with any employee or independent contractor. Thousands, if not millions, of noncompete agreements in existence today would cease to have any legal effect if the FTC's rule becomes final. Under current law, noncompete agreements are governed by state and common law. Most states place limits on noncompete agreements, requiring their geographic scope, duration and competitive activity restrictions to be reasonable. This leaves the enforceability of noncompete agreements subject to courts' interpretations of what constitutes "reasonable." While several states have banned or restricted the use of noncompete agreements, the FTC's proposed rule would create a nationwide ban on noncompete clauses—with very limited exceptions—supplanting state and common law.

Although the proposed rule does not create any new obligations for employers, it could have a massive impact on nearly every employer and the U.S. economy as a whole. According to the National Employment Law Project, 18% of employees are required to sign noncompete agreements as a condition of employment. Approximately 1 in 5 U.S. workers are subject to noncompete agreements; in certain industries, such as technology, that number is much higher. Banning noncompete agreements would allow employees to work for competitors or start competitive businesses.

The FTC's goal in banning these clauses is to increase workforce competition between employers, as organizations could hire employees who were previously restricted by noncompete agreements. This could alter how compensation negotiations for executives and key employees are conducted. Additionally, employers would likely increasingly use confidentiality, trade secret and other protective clauses to protect their legitimate business interests.

Next Steps

Employers can submit comments to the FTC regarding the proposed rule. All comments must be received on or before March 20, 2023. Even after the FTC completes the notice and 60-day comment period, it will likely be some time before this proposed rule becomes final, if ever, as the agency's rule is likely to be challenged legally. There are concerns about whether the FTC has the authority to regulate noncompete agreements under the FTCA. If the challenges are successful, the proposed noncompete ban may never become final or only portions of it will. Impacted employers can take steps now to protect themselves, such as reviewing their agreements with employees and independent contractors to ensure any restrictive covenants contained therein are enforceable.

Summary

If the FTC's proposed rule becomes final, it would have a significant impact on most employers. Understanding the proposed ban on noncompete clauses and its potential impacts allows employers to prepare, adapt and set their organizations up for long-term success. Impacted employers will want to follow the FTC's rule-making process closely.

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