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Kirkland Alert

## Federal Trade Commission's Proposed Ban on Noncompete Agreements

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### Key Takeaways

- On January 5, 2023, the Federal Trade Commission (FTC) issued a notice of proposed rulemaking (the Proposed Rule) that would prohibit employers from using noncompete clauses in contracts with workers, categorizing them as an “unfair method of competition” under Section 5 of the FTC Act.
- The Proposed Rule would require employers to rescind existing noncompete agreements and to inform workers that these agreements no longer have force or effect, and to cease entering into any similar agreements in the future.
- The Proposed Rule is subject to an initial 60-day public comment period, and the FTC is currently “asking for the public’s opinion on its proposal to declare that non-compete clauses are an unfair method of competition, and on the possible alternatives to this rule[.]” The FTC has extended the original March comment deadline to April 19, 2023.
- After the comment period closes, the FTC may vote to implement the Proposed Rule as originally proposed or as updated. It has not yet provided a timeline for final action.
- Commissioner Wilson (the sole Republican appointee), issued a pointed dissent, questioning both the substantive foundation of the Proposed Rule and the FTC’s authority to issue it. Her dissent foreshadows legal challenges to any Rule, if ultimately implemented.

### The Noncompete Proposed Rule

If enacted, the FTC's Proposed Rule would prohibit employers from implementing noncompete agreements with workers. It would further require employers to rescind existing noncompete agreements and actively inform workers that any agreements are no longer in effect.

Importantly, the Proposed Rule provides a limited carve-out for noncompete clauses that meet two requirements: they were (1) entered into by a person who is selling or otherwise disposing of all of the person's ownership interest in a business entity or selling all or substantially all of a business entity's operating assets, and (2) when the person restricted by the noncompete clause is a substantial owner of, or substantial member or substantial partner in, the business entity at the time the person enters into the noncompete clause. "Substantial owner, substantial member, and substantial partner" [are defined as](#) an owner, member, or partner holding at least a 25 percent ownership interest in a business entity.

While the Proposed Rule does not expressly target other types of restrictive covenants like **nonsolicitation** or **noninterference** agreements, these restrictions could be subject to the ban if they were so broad in scope as to effectively function as a noncompete. The Proposed Rule goes so far as to say that, if a **nondisclosure** agreement is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment, it could be viewed as a prohibited noncompete.

The FTC's claimed rationale for the Proposed Rule is that noncompete clauses constitute "unfair methods of competition" in violation of Section 5 of the Federal Trade Commission Act, and that Section 6(g) of the FTC Act allows it to promulgate rules defining unfair methods of competition. The Proposed Rule follows both the FTC's recent [Section 5 Policy Statement](#) and [President Biden's 2021 executive order](#) directing the FTC to investigate the use of noncompete clauses and other agreements that may limit worker mobility. The FTC claims this new Proposed Rule could increase workers' earnings by nearly \$300 billion per year and expand career opportunities for approximately 30 million Americans currently bound by these clauses.

While the legality of noncompete agreements has traditionally been regulated at the state level, the FTC's Proposed Rule purports to supersede any state statute, regulation, order, or interpretation to the extent that it may be inconsistent with the Proposed Rule's requirements, unless it affords worker protection that is *greater* than the protection the Proposed Rule provides.

## Next Steps and Implications

The FTC is seeking public comment on the Proposed Rule until April 19, 2023. In particular, the Proposed Rule seeks comment regarding (1) whether the Rule should apply different standards to noncompetes covering senior executives or other highly paid workers, (2) whether the rule should cover noncompetes between franchisors and franchisees, and (3) what other tools employers may be able to use to protect valuable investments. Concerned stakeholders should consider working with counsel to submit comments in the coming weeks.

The Commission has not disclosed a timeline for final decision or action. If enacted in any form, however, we expect the Rule will face numerous legal challenges.

[Commissioner Wilson's dissent](#) highlights that the Proposed Rule "is vulnerable to meritorious challenges that (1) the Commission lacks authority to engage in 'unfair methods of competition' rulemaking, (2) the major questions doctrine addressed in *West Virginia v. EPA* applies, and the Commission lacks clear Congressional authorization to undertake this initiative," and (3) "it is an impermissible delegation of legislative authority under the non-delegation doctrine." Already, members of the business community, including the [Chamber of Commerce](#), have argued that the FTC lacks the legal authority to promulgate such a rule. And others argue further that, in any event, the Rule would harm the public by, among other things, ignoring the legitimate role tailored noncompete clauses play in appropriate situations, including helping to protect an employer's investment in and training of employees, and its disclosure of trade secrets and other proprietary business information to those employees.

Moreover, as drafted, the Proposed Rule raises meaningful questions about the FTC's power to limit state statutes and other state law permitting noncompete agreements – which have survived in parallel with Section 5 for over a century. The Biden Administration and the FTC's Proposed Rule come at a time when certain state legislatures have passed (and others are considering) statutes limiting noncompete clauses and some state and federal courts have subjected noncompete clauses to increased scrutiny. Whether unelected federal regulators operating through agency rulemaking can properly usurp the actions of elected officials is but one of the questions this Proposed Rule is likely to raise.

Finally, little is known regarding how exactly the FTC would enforce the Rule. The FTC has only ever promulgated one other rule defining unfair methods of competition – and it was never enforced. Unlike other statutes underlying FTC-enforced rules, such as Sections 5 and 18 of the FTC Act, Section 6(g) of the FTC Act, which the FTC

contends authorizes this rulemaking, contains no information regarding enforcement procedures or potential sanctions.

## The Bottom Line

While the legal framework for noncompete clauses and related restrictive covenants remains uncertain, companies seeking to protect their investments in their employees and confidential information should take stock of their existing covenants and should enlist experienced counsel in the early stages of any disputes related to enforcement of those covenants. The FTC has signaled increased scrutiny of these kinds of practices, and companies should be prepared. Other solutions, like carefully drafted confidentiality and intellectual property agreements, may provide companies in some situations with the protection they need without the risks or uncertainty associated with noncompete clauses. Creative incentive compensation arrangements may also reduce the risk of losing talent and make employees more likely to stay, let alone leave and compete. Likewise, thoughtful business solutions, like proper internal procedures, review and restrictions regarding departing employees who have access to particularly sensitive information, can help prevent disputes.

***Please feel free to contact Kirkland if you have any questions regarding legal or business strategies to protect your investment in your employees and your confidential information in this evolving environment.***

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## Suggested Reading

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- 02 February 2023 Kirkland Alert 2023 EU Antitrust & FDI Update
- 27 January 2023 Kirkland Alert Revised Hart-Scott-Rodino Act Thresholds, Filing Fees and Civil Penalty Amounts Announced

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