
FTC Announces Proposed Rule Banning Employers From Entering Non-compete Clauses With Employees

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On January 5, 2023, the Federal Trade Commission (FTC or Commission) announced a notice of proposed rulemaking that would ban employers from entering non-compete agreements with their employees. Under proposed rule 16 CFR § 910, it would be an unfair method of competition (UMC) in violation of Section 5 of the FTC Act for an employer to enter, or attempt to enter, a non-compete clause with paid or unpaid staff or independent contractors.¹

The proposed rule marks a significant step in the FTC's plans to use its rulemaking authority to sanction conduct it views as deleterious to workers and the economy. As written, it is also a radical departure from current federal antitrust law, which calls for an assessment of the competitive effects of the non-compete clause in a relevant market to determine whether it is unlawful.

The proposed rule will be subject to public comment for 60 days and is likely to be highly controversial. If this or a similar rule were to issue, litigation about whether the FTC has the statutory power to engage in UMC rulemaking is virtually certain.

The FTC announced the proposed rule the day after it announced consent decrees with three employers and two individuals for entering non-compete clauses with their employees,² which were alleged to constitute “stand alone”

¹ Notice of Proposed Rulemaking for Non-Compete Clause Rule (NPRM) (Jan. 5, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf.

² Press Release, FTC, FTC Cracks Down on Companies That Impose Harmful Noncompete Restrictions on Thousands of Workers (Jan. 4, 2023), <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-cracks-down-companies-impose-harmful-noncompete-restrictions-thousands-workers>.

Section 5 violations grounded in UMC without any allegations that the clauses were illegal restraints of trade under Section 1 of the Sherman Act.

The Proposed Ban on Non-compete Clauses

“The freedom to change jobs is core to economic liberty and to a competitive, thriving economy,” FTC Chair Lina M. Khan said in a statement accompanying the publication of the proposed rule.³ Highlighting the political significance of the FTC’s action, President Biden quickly endorsed the proposal, describing it on Twitter as a “huge win for workers.”⁴

The proposed rule is a significant step in the FTC’s plans to use its rulemaking authority against conduct it views as harmful to workers and the economy. The proposed rule would prohibit employers from maintaining existing non-compete clauses or entering new ones starting on the proposed effective date, which would occur 180 days after the final rule is published in the *Federal Register*.⁵ Within 45 days of the effective date, employers would be required to notify current employees (and former employees where the employer has the former worker’s contact information readily available) that their non-compete clauses are no longer in effect.⁶

While the proposed rule is sweeping in scope, it includes certain limitations. Traditional agreements prohibiting employees from disclosing confidential company information or soliciting the company’s customers would fall outside the proposed rule.⁷ Moreover, the proposed rule would exempt certain non-compete clauses imposed on the seller or substantial owner of a business.⁸

The notice of proposed rulemaking requests comment on various alternatives to the proposed rule.⁹ These include a rebuttable presumption of unlawfulness (instead of an outright ban) and a set of different rules for different categories of workers. One of the alternatives describes a rule banning non-competes for most workers while applying a rebuttable presumption against non-competes for workers whose income exceeds a certain threshold.¹⁰ The public will have a 60-

³ Press Release, FTC, FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition (Jan. 5, 2023), <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition>.

⁴ President Joseph R. Biden (@POTUS), TWITTER (Jan. 5, 2023, 2:48 PM), <https://twitter.com/potus/status/1611087261243686912>.

⁵ NPRM Part V, Section 910.5.

⁶ NPRM Part V, Section 910.5.

⁷ NPRM Part IV.B.2.

⁸ NPRM Part V, Section 910.3.

⁹ NPRM Part VI.

¹⁰ NPRM Part VI.A.

day period to comment on the proposed rule and its alternatives, after which the FTC will consider comments before issuing a final rule.¹¹

The FTC's Focus on Non-compete Clauses

The proposed rule comes one day after the FTC announced groundbreaking enforcement actions against three companies and two individuals whose non-competes the agency found to be UMCs in violation of Section 5 of the FTC Act.¹² The FTC announced its settlement with Prudential Security, Inc., and Prudential Command, Inc., affiliated security guard companies, and the companies' two co-owners and officers.¹³ On the same day, the agency announced that it had reached settlements with glass container manufacturers O-I Glass, Inc., and Ardagh Group S.A.¹⁴ The orders issued against the companies and individuals enjoin them from entering, maintaining, enforcing or threatening to enforce a non-compete agreement against an employee.¹⁵

The complaints in those cases, consistent with the Commission's announced intent to apply Section 5 aggressively, alleged only a "stand alone" Section 5 violation grounded in UMC and did not allege any illegal restraint of trade under Section 1 of the Sherman Act. Absent a per se theory, a Section 1 allegation would have required the FTC to plead that the non-compete harmed competition and failed a rule-of-reason assessment (which also would have considered procompetitive benefits from the non-compete clause). These complaints presaged the proposed rule's departure from the traditional assessment of a non-compete clause's actual effects on competition. Historically, courts have frequently upheld non-compete clauses, absent significant overbreadth in terms of length or scope, often finding that they will not significantly harm competition or that they bring significant procompetitive benefits—e.g., enabling employers to freely share confidential information with their employees to facilitate better performance or investment in employee training.

¹¹ NPRM Part V, Section 910.5.

¹² Press Release, FTC, *supra* note 2.

¹³ See generally Complaint, *In re Prudential Security Inc., et al.*, FTC Matter No. 2210026 (Jan. 4, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/2210026prudentialsecuritycomplaint.pdf.

¹⁴ See generally Complaint, *In re Ardagh Group S.A., et al.*, FTC Matter No. 2110182 (Jan. 4, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/2110182ardaghcomplaint.pdf; see also Complaint, *In re O-I Glass, Inc.*, FTC Matter No. 2110182, https://www.ftc.gov/system/files/ftc_gov/pdf/2110182o-iglasscomplaint.pdf.

¹⁵ See Decision and Order, *Prudential Security Inc. et al.*, at 2, FTC Matter No. 2210026 (Jan. 4, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/2210026prudentialsecurityproposedorder.pdf; see also Decision and Order, *Ardagh Group S.A., et al.*, at 3, FTC Matter No. 2110182 (Jan. 4, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/2110182ardaghdraftorder.pdf; Decision and Order, *O-I Glass, Inc.*, FTC Matter No. 2110182, at 2, https://www.ftc.gov/system/files/ftc_gov/pdf/2110182o-iglassdraftorder.pdf.

“The FTC is committed to ensuring that workers have the freedom to seek higher wages and better working conditions without unfair restrictions by employers,” FTC Bureau of Competition Deputy Director Rahul Rao said in a January 4 statement.¹⁶ “The FTC will continue to investigate, and where appropriate challenge, noncompete restrictions and other restrictive contractual terms that harm workers and competition.”¹⁷

These recent FTC developments reflect the aggressive stance the Biden Administration and the current Commission majority have taken regarding the agency’s rulemaking and enforcement authority under the FTC Act. In July 2021, President Biden issued an executive order encouraging the Commission to consider exercising the agency’s rulemaking authority to curtail the use of non-compete clauses.¹⁸ That same month, the FTC rescinded its 2015 policy that limited its enforcement ability under the FTC Act,¹⁹ and in November 2022, the agency issued a statement outlining its policy of aggressively employing its authority under the FTC Act.²⁰

Looking Ahead

The proposed rule and other recent developments have significant implications. As written, the proposed rule would effectively ban non-competes in most employment circumstances, a radical departure from current federal antitrust law, which focuses on analysis of competitive effects to determine whether a non-compete clause is unlawful. While many states impose limitations on non-competes, only three states have adopted statutes that make non-compete clauses void for nearly all workers.²¹ If the proposed rule is promulgated, many employers will have to comply with a standard that is more absolute than applicable state law.

¹⁶ Press Release, FTC, *supra* note 2.

¹⁷ *Id.*

¹⁸ Exec. Order No. 14036, 3 C.F.R. 609 (2022), <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/>.

¹⁹ Press Release, FTC, FTC Rescinds 2015 Policy that Limited Its Enforcement Ability Under the FTC Act (July 1, 2021), <https://www.ftc.gov/news-events/news/press-releases/2021/07/ftc-rescinds-2015-policy-limited-its-enforcement-ability-under-ftc-act>.

²⁰ See Lina Kahn, Statement on the Adoption of the Statement of Enforcement Policy Regarding Unfair Methods of Competition Under Section 5 of the FTC Act (Nov. 10, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/Section5PolicyStmtKhanSlaughterBedoyaStmt.pdf; *see also* Press Release, FTC, FTC Restores Rigorous Enforcement of Law Banning Unfair Methods of Competition (Nov. 10, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/11/ftc-restores-rigorous-enforcement-law-banning-unfair-methods-competition>.

²¹ California, North Dakota and Oklahoma. See Cal. Bus. & Prof. Code sec. 16600; N.D. Cent. Code sec. 9-08-06; Okla. Stat. Ann. tit. 15, sec. 219A.

The FTC's policy agenda presents new terrain for companies to navigate. The proposed rule would create substantial challenges for employers seeking to protect proprietary information or their investment in training employees. Moving forward, companies may have to rely on other avenues for protection, such as non-disclosure agreements or trade secret law. But non-disclosure agreements are typically seen as less effective than non-competes, in part because of the difficulty in monitoring compliance. Enforcing trade secret laws may entail litigation that is much more expensive and burdensome than litigation to enforce a contractual non-compete clause.

In a 14-page dissenting statement regarding the notice of proposed rulemaking, Christine Wilson, the FTC's sole Republican commissioner, encouraged public comment from interested stakeholders, including comment on proposed alternatives to the near-complete ban on non-compete provisions.²² In her dissent, Commissioner Wilson questioned whether the FTC has competition rulemaking authority under the FTC Act and observed that the proposed rule "represents a radical departure from hundreds of years of legal precedent that employs a fact-specific inquiry into whether a non-compete clause is unreasonable in duration and scope, given the business justification for the restriction."²³

If the proposed rule were to issue in its current or a similar form, litigation about whether the FTC has the statutory power to engage in UMC rulemaking is a near certainty. Opponents of the rule likely will argue, among other things, that the FTC Act does not satisfy the standard set forth in the Supreme Court's recent decision in *West Virginia v. EPA*.²⁴ That case held that the Environmental Protection Agency—an independent agency similar to the FTC—must point to "clear congressional authorization" to undertake a novel rulemaking approach.²⁵

WilmerHale's antitrust and administrative law litigation experts are available to address questions about the significance and potential implementation of the proposed rule, as well as to help clients submit comments on FTC and other agency-proposed rules.

²² *Id.*

²³ Christine Wilson, Dissenting Statement of Commissioner Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule (Jan. 5, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf.

²⁴ 142 S. Ct. 2587, 213 L. Ed. 2d 896 (2022).

²⁵ *Id.* at 2609.

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