FTC Proposes Ban on Non-Compete Agreements

Client Alert

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What You Need to Know

- The FTC has proposed a new rule which, if adopted in its current form, would prohibit nearly all private employers from entering into or enforcing non-compete agreements with their employees.
- The proposed rule would supersede any state laws related to non-compete agreements that are inconsistent with the provisions of the rule if the protection those state laws afford workers is less than the protection provided under the rule.
- The proposed rule would impact non-compete agreements currently in effect as well as those that would become effective at a later date.
- Employers should proactively consider the potential ramifications of this broad-based rulemaking on their business interests.

By: Thomas C. Senter

On January 5, the Federal Trade Commission (FTC) issued an extremely broad Notice of Proposed Rulemaking which would prohibit the use of non-compete agreements in most cases. The issuance of the Notice was not surprising, as in July 2021 President Biden issued an Executive Order directing the FTC to curtail the use of non-competes and other provisions that may restrict worker mobility. However, the breadth of the Notice is greater than what most practitioners expected.

The FTC Notice is subject to a 120-day comment period and will then become effective 60 days after it is issued in final form. We expect there to be numerous comments and legal challenges to the Notice, and any rule that is issued by the FTC in final form may differ in many respects from what is contained in the Notice issued last week. Nonetheless, it is important for employers to be aware of the proposed rule and consider how it may impact their business, including any action employers may need to take upon the FTC's adoption of the rule in final form.

The following is not intended to be a comprehensive discussion of the 218-page Notice of Proposed Rulemaking, but instead provides an overview of certain provisions which employers should have on their radar at this stage:

- A non-compete agreement is defined by the FTC 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 with the employer."
- In terms of the impact on New Jersey employers, because the proposed rule would supersede any state laws related to non-compete agreements that are inconsistent with the provisions of the rule if the protection those state laws afford workers is less than the protection provided under the rule, the proposed rule could theoretically be beneficial to New Jersey employers if it "leveled the playing field" with employers in other states. However, to the extent that New Jersey adopts legislation that is more protective of the rights of employees than the final rule, workers in New Jersey may have more protection in this area than those in certain neighboring states. Over the last several years, several bills have been introduced in New Jersey which provide greater worker protection in certain instances than the rule proposed by the FTC. New Jersey Assembly Bill A3715, which was introduced last year, is one such example. It remains to be seen whether New Jersey will drop its efforts to issue its own legislation once the rule is issued in final form.
- In its present form, the rule would generally apply to all workers. Those paid on a Form 1099 basis would be subject to the rule to the same extent as W-2 employees.
- There are limited exceptions to the application of the rule, including in the case of a worker that has a 25% or greater ownership interest in a business that is sold. There is also an exception for businesses that are not organized to make their own profit or to make profit for their members. While we do not know what the final rule will provide, this exception seems to mean that a non-profit hospital or hospital system would be able to restrict its physicians and executives from going to work for a competitor – but that a for-profit hospital, insurance company or private equity firm employing a physician or executive could not impose such a restriction. Query whether this may cause individuals who might otherwise work for a non-profit hospital or system to instead seek employment in the for-profit sector.
- Upon enactment, the rule in its present form would apply to agreements that are in effect at that time, as well as those that are adopted or would otherwise become effective in the future. Employers would have to issue a notice of recission to current and former workers subject to a restriction on competition within 180 days of the issuance of the final rule. While non-compete provisions would no longer be enforceable, other provisions which were negotiated in exchange for a non-compete, including severance payments, would remain in effect.
- The FTC Notice indicates that non-disclosure and non-solicitation agreements will generally not be subject to the new rule. However, if those agreements are deemed too broad in scope, the FTC may take the position that they are also unenforceable.

Next Steps for Employers

As previously indicated, we expect a host of comments and legal challenges to the proposed rule. Issues that will undoubtedly be raised include whether the restrictions on competition should apply to senior executives and whether there should be different rules based on the level of the worker's compensation.

At this point in time, employers should review which of their employees are subject to non-compete agreements and other restrictive covenants and consider the potential impacts of the proposed rule if adopted in its current form, including the protection of proprietary business information.

Employers may also wish to note that the FTC is accepting public comments to the proposed rule online through March 10, 2023, after which time the rule will be finalized and announced.

Members of the firm's Employment Law Department are continuing to study and monitor the FTC's Notice of Proposed Rulemaking as well as related pending legislation in New Jersey. We encourage you to reach out with questions concerning the proposed rules and how they may impact you or your business.

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