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Meridian Client Update

FTC Proposes Ban on Non-compete Provisions

On January 5, 2023, the Federal Trade Commission (FTC) issued a proposed rule that would ban the use of non-compete provisions. The FTC has preliminarily determined that non-compete clauses are an unfair method of competition and therefore represent a violation of Section 5 of the Federal Trade Commission Act.

The FTC's proposed rule would prohibit employers from entering into, or maintaining existing, non-compete clauses with workers. Thus, employers would be required to *rescind* existing non-compete clauses. The FTC estimates that the proposed rule would increase American workers' earnings between $250 billion and $296 billion per year.

Based on concerns about claimed harms to workers and to competition, the FTC proposed rule on non-compete clauses provides the following:

- Applies to nearly all forms of business organizations, including partnerships, corporations, associations, limited liability companies and other legal entities, or a division or subsidiary thereof.[1]
- Declares non-compete clauses as an unfair method of competition.
- Prohibits employers from entering into, or maintaining existing, non-compete clauses with their workers, including independent contractors. However, the proposed rule excludes from the definition of worker a franchisee in the context of a franchisor-franchisee relationship.
- Requires employers to rescind existing non-compete clauses with workers that impose post-employment constraints and provide notice to current and former employees that such clauses are no longer in effect within 45 days of rescinding the clause.
- Defines non-compete clause to mean "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 the release to the proposed rule, the FTC has indicated the prohibition on non-compete clauses generally would not apply to other restrictive covenants on employment, such as non-solicitation and nondisclosure

[1] A person that hires or contracts with a worker to work for the person would be an employer under proposed rule regardless of whether the person meets another legal definition of employer, such as a definition in federal or state labor law. The proposed rule would not apply to certain entities including certain banks, savings and loan institutions, federal credit unions, common carriers, air carriers and foreign air carriers, and persons subject to the Packers and Stockyards Act of 1921, as well as an entity that is not organized to carry on business for its own profit or that of its members.

agreements, unless a restriction is so broad in scope that it functions as a non-compete clause.[2] For example, a non-disclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer would be treated as a prohibited non-compete clause.

The proposed rule would **not** apply to a non-compete clause that is entered into by a person who is selling a business entity or its operating assets (or disposing of their ownership interest in the business), when the person restricted by the non-compete clause is a substantial owner of the business entity at the time the person enters into the non-compete clause.

The propose rule would preempt state laws governing non-compete clauses to the extent inconsistent with the proposed rule, but would not preempt state laws that provide greater protections.

The FTC is 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 the proposed rule. The FTC seeks public comment on a number of topics, in particular:

- Whether senior executives should be exempted from the rule, or subject to a rebuttable presumption rather than a ban.
- Whether low- and high-wage workers should be treated differently under the rule.
- Whether franchisees should be covered by the rule.

The public comment period will end 60 days after the proposed rule is published in the Federal Register.[3]

If adopted by the FTC, the final rule prohibiting non-compete clauses would be effective 60 days after its publication in the Federal Register. Employers would be required to comply with the final rule 180 days after its publication in the Federal Register. The FTC believes the 180 day period would provide employers adequate time to modify existing agreements or arrangements as needed to comply with the final rule.

Meridian comment. The threshold issue raised by the FTC proposal is whether the agency has the authority to ban non-compete clauses. Some public commentary suggests the enactment of the ban would exceed the FTC's authority and, as a result, would not survive judicial scrutiny. At a minimum, we would expect a final rule banning non-compete clauses to draw lawsuits from business interests seeking to enjoin its implementation.

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The ***Client Update*** is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

[2] The FTC's proposed rule adopts a functional test for whether a contractual term is a non-compete clause – i.e., whether the provision has the effect of prohibiting 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.

[3] As of the date of this Client Update, the FTC has yet to publish the proposed rule in the Federal Register.