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FTC Proposes to Ban Employee Noncompete Agreements

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On January 5, 2023, the Federal Trade Commission ("FTC") proposed a rule (the "Proposed Rule") that would prohibit companies from imposing post-employment noncompete agreements. If enacted, the Proposed Rule would bar employers from entering into noncompete agreements with employees, independent contractors, and unpaid workers, and would require employers to repeal or nullify any existing restrictions within six months of the Proposed Rule's effective date.

The Proposed Rule would permit noncompete agreements in connection with the sale of a business, but only where the party restricted by the non-compete clause is an owner, member, or partner holding at least a 25 percent ownership interest in a business entity. The Proposed Rule would not prohibit non-disclosure agreements ("NDAs") or customer non-solicitation agreements because, as the FTC has explained, "these covenants generally do not prevent a worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer."

The public will have 60 days to submit comments on the Proposed Rule. Presumably, the FTC will then move to make the proposal final. Legal challenges are all but certain, both in terms of the substance and the FTC's legal authority to impose such a wide sweeping pronouncement without legislative approval. The Proposed Rule contemplates an effective date 180 days after the final version is published.

Given prior actions by the Biden Administration, this action by the FTC is not surprising (except perhaps the breadth of prohibition). As we mentioned in our previous article, President Biden issued an Executive Order in July 2021 that made clear his administration would be scrutinizing noncompete agreements and encouraging the FTC to ban or substantially limit them. Also, both the FTC and the Department of Justice recently have been focusing on labor-related conduct, and have been investigating and even bringing enforcement actions against agreements and consolidations that allegedly restrain competition in labor markets.

In addition to the Proposed Rule, the FTC announced that it has reached settlements with three large companies to release employees from what the FTC called unfair noncompete agreements, further demonstrating the FTC's increased scrutiny of noncompete agreements.

Similar to the action at the federal level, many states have taken steps in recent years to restrict or limit the enforceability of employment noncompetes. Multiple states now require that a job applicant receive a noncompete at least 14 days prior to their start date. Colorado now requires an employee to be paid over $100,000, the District of Columbia has a $150,000 annual salary threshold, and Illinois requires an employee be paid at least $75,000 per year to be subject to a noncompete. States such as Maine, Massachusetts, Maryland, Virginia and Washington, DC prohibit noncompetes for hourly workers. In one way or another, almost half of the states restrict the ability of employers to enforce noncompete agreements against employees. And for many years, states like California, Oklahoma, and North Dakota have deemed employment noncompete agreements largely unenforceable.

Against this backdrop, HR professionals must also remember that, in October 2016, the FTC

and the Department of Justice Antitrust Division (the "Division") jointly issued their "Antitrust Guidance for Human Resource Professionals." There, the agencies gave notice that the Division would "proceed criminally against naked wage-fixing or no-poaching agreements." Agreeing with individual(s) at another company about employee salary or other terms of compensation, either at a specific level or within a range (so-called wage-fixing agreements, or agreeing with individual(s) at another company to refuse to solicit or hire that other company's employees (so-called "no poaching" agreements), may result in criminal prosecution.

The Lowenstein Sandler Employment Counseling & Litigation practice group regularly counsels companies on the complexities of covenants against competition and other restrictive covenants, both in the employment and corporate context. Our Antitrust/Competition practice group counsels clients on all aspects of their business from advising on the competitive implications of proposed transactions to minimizing the risk associated with new and innovative ways to do business. Please contact the authors or any other Lowenstein Sandler attorney with whom you regularly work if you have any questions about the Proposed Rule.

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