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This Memorandum relates to a recently proposed rule from the Federal Trade Commission that would ban almost all non-compete clauses nationwide. Below is a summary of the background of the Proposed Rule, its text and effect on businesses, and potential challenges to its final promulgation.

I. The Proposed Rule's Background

On January 19, 2023, the Federal Trade Commission published a Proposed Rule to ban non-compete agreements. This Proposed Rule follows President Biden's executive order of July 9, 2021, which directed various federal agencies to take more vigorous action to counteract business practices that were perceived as hindrances to competitive markets. The Chair of the FTC, in particular, was ordered to "consider working with the rest of the Commission to exercise the FTC's statutory rulemaking authority under the Federal Trade Commission Act to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility." In support of the Proposed Rule, the FTC argues that non-competes depress wages, even for workers not covered by a non-compete; create inefficiency in labor markets by hindering optimal job-worker matches; increase racial and gender wage gaps; and decrease innovation by preventing talent acquisition, among other harms.

II. The Proposed Rule's Substance

a. *Definitions*

The Proposed Rule applies to "non-compete" clauses, which it defines 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." The Proposed Rule assures the expansive interpretation of "non-compete clause" by adopting a "functional test" for determining what counts as a non-compete clause. The "functional test" looks at whether the clause "has the effect of prohibiting" the worker from taking other employment or operating a business after leaving his current employment. Examples of *de facto* non-compete clauses given in the Proposed Rule include non-disclosure clauses so broadly worded that they prevent the worker from taking employment in the same field, or that require the worker to

reimburse training costs if he or she leaves within a specific period of time if the required payment is not reasonably related to the actual costs of the training.

"Worker" is also broadly defined, and includes both paid and unpaid, employee and independent contractor, volunteer, extern, apprentice, or sole proprietor, but includes an exception for franchisees, as will be explored later.

b. *Prohibited Activity*

Using the stated definitions, the proposed regulation enforces a blanket ban on non-compete clauses, including (1) entering into, (2) attempting to enter into, (3) maintaining, or (4) without a good-faith basis representing that a worker is subject to, a non-compete clause.

c. *Action Required from Employers*

As just referenced, the proposed regulation would bar the maintenance of a pre-existing non-compete clause. Section 910.2(b) would require employers to rescind any existing non-compete clauses by the compliance date (180 days after publication of the final rule) and to provide notice to affected workers of the rescission.

After rescinding any current non-compete clauses, the employer would be required to provide notice to the worker that complies with the following:

1. **Content of Notice:** The employer must provide notice to the worker that (1) the worker's non-compete clause is no longer in effect, and (2) the non-compete clause may not be enforced against the worker. The proposed rule provides model language for the notice.

2. **Timing of Notice:** Notice must be given within 45 days of rescinding the non-compete clause.

3. **Subjects of Notice:** Notice must be given to any worker currently employed by the employer and to any worker formerly employed by the employer, but only if the former worker's contact information is "readily available" to the employer.

4. **Delivery of Notice:** Notice must be delivered to each affected worker individually, "on paper or in a digital format," including by text message or e-mail. The proposed rule does not appear to contemplate giving notice orally, either in person, by phone, or by recorded message.

Lest there be any confusion about how to rescind a non-compete clause, the proposed rule includes a safe harbor provision, whereby an employer complies with the rescission requirement if it provides the prescribed notice.

d. *Exceptions*

There are several important circumstances under which the Proposed Rule does not apply, either by its own terms or by force of other laws.

1. **Sale of Business:** As is typical of current state non-compete laws, the proposed regulation would provide a more relaxed standard for the sale of business context. Specifically, the proposed rule would not apply to a substantial owner, member, or partner of a business entity (defined as one holding "at least a 25 percent ownership interest in a business entity") when he or she is selling all or substantially all of his or her ownership interest in a business entity or is selling all or substantially all of the business entity's operating assets. Thus, some non-competes in the sale of business context would still be governed by federal and state antitrust and non-compete law.

2. **Franchisee-Franchisor Relationship:** The Proposed Rule bans non-competes between employers and "workers," but the Proposed Rule expressly excludes "a franchisee in the context of a franchisee-franchisor relationship" from its definition of "worker." Since only non-competes applied to "workers" are designated unfair business practices under the Proposed Rule, franchisors would still be able to enter into and enforce non-competes against their franchisees.

3. **Businesses not Regulated by the FTC:** Certain businesses, namely banks, savings and loan institutions, Federal credit unions, common carriers, air carriers and foreign air carriers, and persons and businesses subject to the Packers and Stockyards Act of 1921 (with some exceptions), are not subject to the FTC's regulatory authority. Consequently, the Proposed Rule will not affect the aforementioned businesses' use of non-compete clauses.

e. *Effect on Current State Laws*

Federal regulations benefit from the Supremacy Clause of the United States Constitution and, therefore, may pre-empt state laws. The Proposed Rule specifically provides that it would supersede any inconsistent state law.

Consequently, if the Proposed Rule is made final, state non-compete law would remain effective in only two situations: (1) where state laws are more protective of workers than the proposed regulation (if possible), and (2) where persons or transactions specifically exempted by the Proposed Rule or business not regulated by the FTC are involved.

III. The Proposed Rule's Future

After an extension of time, the Proposed Rule is now open for comment through April 19, 2023. To date, over 19,000 comments have been submitted.

After comments have closed, the FTC will review all submitted comments and either continue the rulemaking process, modify the Proposed Rule, or withdraw the Proposed Rule. "Major rules," such as the Proposed Rule, can become effective no fewer than sixty days after publication in the Federal Register.

Should the FTC proceed to publish the Proposed Rule as a final rule, several major obstacles remain.

First, under the Congressional Review Act, Congress has sixty days after a rule is submitted to it to pass a joint resolution of disapproval, which, if signed by the President or passed by a sufficient majority of both houses, prevents the rule from becoming effective. Notably, members of the House Judiciary Committee have already voiced opposition to the Proposed Rule, while members of the Senate have proposed legislation to ban non-compete clauses in most circumstances.

Second, legal challenges to the Proposed Rule are certain. The U.S. Chamber of Commerce, for example, has already threatened to sue to block the Proposed Rule. Legal challenges are likely to proceed along three lines:

(1) Lack of authority. The FTC Act declares "[u]nfair methods of competition" unlawful and enables the FTC to "make rules and regulations for the purpose of carrying out the provisions of this Act." It is not clear, however, that the FTC has the authority to substantively define "unfair methods of competition," as it attempts to do in the Proposed Rule.

(2) Major questions doctrine. The Supreme Court has held that, where federal agencies assert broad authority to make regulations with great political and economic significance, clear congressional authorization to exercise such authority is required. There is a strong argument that the Proposed Rule enters "major question" territory by declaring non-compete clauses illegal throughout the United States, and, as noted in

the previous point, clear congressional authorization for such action is questionable.

(3) Non-delegation doctrine. The non-delegation doctrine preserves the separation of powers written into the U.S. Constitution by preventing Congress from granting legislative responsibilities to other bodies. It likely will be argued that, even if a court finds that the FTC acted with congressional authorization, that authorization was void for violating the non-delegation doctrine.

The Proposed Rule, therefore, faces certain and substantial legal challenges in its current form. While the outcome in the courts cannot be predicted, at the very least, it is certain that the Proposed Rule will be tied up in litigation for some time if it is promulgated as a final rule.

IV. Conclusion

If the Proposed Rule survives the hurdles currently lined up, it will have an enormous effect on employers and workers throughout the United States. However, given that the language and substance of any final rule promulgated by the FTC may well differ from the Proposed Rule and that significant legal challenges may delay or stop its implementation, there is no reason to panic. Instead, businesses should consult with legal counsel to prepare for the outcomes from the regulatory and legal processes. Such preparation includes (1) ensuring that current agreements comply with existing and evolving state laws; and (2) considering additional protections relating to trade secrets.

If you have any questions about the Proposed Rule, please contact Craig Patterson at cpatterson@beckmanlawson.com or 260.425.1643 or Noah Vancina at nvancina@beckmanlawson.com or 260.425.1657.