FTC Insights: How Employers Can Prepare for a World Without Noncompetes

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When the FTC proposes a rule that could regulate nearly *every* employer in the nation, we take notice. In this second installment of our series on the FTC's proposed rule to ban noncompete agreements, we provide a pragmatic look at the road ahead.

What has the FTC actually proposed? How can individual firms and industry groups alike weigh in on one of the most substantial regulatory actions facing employers right now? And what should businesses do to prepare? Here's your deep dive.

Remind me, what exactly would the proposed rule prohibit?

Employers would be prohibited from entering into, attempting to enter into, or maintaining a noncompete agreement with an employee. While noncompetes are often associated with highly-skilled, high-wage employees like corporate executives, they are also used in some lower-paid workforces. According to the FTC, an estimated 30 million people – about one in five American workers – are currently bound to one.

The FTC proposes several additional measures to ensure compliance. Employers would be prohibited from representing to an employee that they are subject to a noncompete without a good faith basis to believe the worker is actually subject to an enforceable agreement. The rule would also prohibit *de facto* noncompete agreements, which includes terms (such as nondisclosure agreements or training reimbursement requirements) that effectively prohibit the employee from working for a competitor even if they are not labeled "noncompetes."

Under the rule, employers would have an affirmative burden of notifying their current and former workers that any existing noncompete agreement is rescinded. The FTC estimates $1.02 to $1.77 billion in one-time costs associated with direct compliance with this proposed rule.

What types of employees and employers are subject to the rule?

Nearly all. Employees ("workers") are broadly defined to include independent contractors, interns, volunteers, and others. Also, the rule would cover any employer subject to the FTC's jurisdiction and would not distinguish between large and small employers. However, the FTC has signaled *some* openness to differentiating between types of employees, particularly executives and highly-skilled or paid workers, and has asked for comment on this issue. (More on that next.)

How can employers and industry groups help shape or stop this proposed rule?

Under the rulemaking procedures being followed here, the FTC must seek and consider public comment before promulgating a final rule. By design, proposed rules are often broad and leave room for some winnowing and reconsidering. The FTC's proposal contains many specific questions and Chair Lina M. Khan issued a statement encouraging a broad swath of market participants, including those with firsthand experience using noncompetes, to submit comments. For employers, areas of particular importance and potential influence include:

- **Exempting senior executives or other highly paid workers.** Both Chair Khan and the FTC more broadly have sought comments on whether the ban should apply to high-paid workers and senior executives with greater bargaining power and who may pose a greater risk as competitors.
- **Safeguarding investments, including trade secrets and confidential information.** Employers are encouraged to weigh in on whether other legal tools, including existing trade secret law and confidentiality agreements, can protect critical investments in the absence of broader noncompetes.
- **A "rebuttable presumption" vs. a ban.** The FTC seeks comment on whether the rule should create a rebuttable presumption that noncompetes are unlawful instead of imposing an outright ban.
- **Other alternatives to the FTC's rule.** To the extent that employers can suggest other viable alternatives to the FTC's proposal, this is the time to do so.

Beyond potentially shaping the final decision, the notice-and-comment period also provides the opportunity for interested parties to ensure that their experiences, concerns, and views are included in the record should a later challenge to the rule become necessary.

What should employers do to prepare?

The FTC's proposal is still just that – a proposal. It may change and will take at least a few months to complete. However, the agency can still bring enforcement actions under Section 5 of the FTC Act, as shown by two it announced (against three companies and two individuals) on the eve of launching this rulemaking. In these first-of-their-kind cases, the FTC argued that the noncompete agreements at hand – including one and two-year post-employment restrictions for workers including security guards, manufacturing workers, and engineers – constituted prohibited unfair methods of competition. The companies were ordered to cease imposing the relevant restrictions and to cease enforcing (and threatening to enforce) the noncompetes. The employers were also required to notify affected employees that they were no longer bound by the existing agreement. In many ways, this order mirrors the requirements under the proposed rule with a similar focus on lower-wage employees Therefore, while the FTC rulemaking process is ongoing, prudent actions may include:

- **Submitting or supporting a public comment.** The comment period is currently open through March 10, 2023. Companies interested in submitting a comment, or supporting a broader industry group comment, should contact counsel for guidance quickly.
- **Review your agreements, past and present.** While there's no immediate need to take action, employers should be aware of how various state laws already impact the enforceability of these agreements. This includes reviewing contracts and terms for existing employees as well as former workers who may still be subject to noncompetes or related restrictions.
- **Prepare for new negotiation dynamics.** The proposed rule would become effective 60 days

after the rule is published but delay compliance for 180 days after publication. It also would offer a 45-day period to provide employees notice of any rescissions – if it doesn't succumb to legal challenges. That means there are at least several months before any ban becomes effective. However, because the publicity surrounding the rulemaking is bound to affect negotiations, employers may want to consider alternative approaches such as ensuring noncompetes are not overly broad or do not target lower-wage workers.

- **Consider different types of agreements.** While the proposed rule would preempt state laws, noncompetes are already enforced differently across the country. Three states – California, North Dakota, and Oklahoma – do not enforce them in most instances. Some 11 other jurisdictions, including Washington D.C. and Illinois, only enforce them for specific groups of workers, often related to earnings. Still others limit their geographic scope and duration, making it a challenge for employers working in multiple states to keep up. As a result, employers may want to consider alternative agreements such as targeted nondisclosure clauses or confidentiality agreements and post-employment consulting agreements, taking care that these alternatives are justified by legitimate interests.

A rulemaking this sweeping is bound for legal scrutiny. In our next post, Kelley Drye's former FTC officials will explore the scope of the agency's authority to propose this ban, how to engage in the rulemaking, and what challenges we're likely to see in the courts.

This blog is part of a collaborative series featuring insight from Kelley Drye's Labor and Employment, Antitrust and Competition, and Advertising Law practices. Revisit our inaugural installment with insights from Kelley Drye partner and FTC veteran William MacLeod here.