

FTC Proposes Nationwide Ban on Post-Termination Non-Compete Agreements

Insights

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On January 5, 2023, the Federal Trade Commission (FTC) formally proposed a rule banning employers from using non-compete agreements nationwide. The FTC's [proposed rule](#) would make it an illegal and “unfair method of competition” for an employer to enter into or attempt to enter into a post-termination non-compete clause with any worker, or to maintain or threaten to enforce an existing non-compete provision against current or former workers. The ban would cover all post-termination non-competes and “de facto” non-competes with employees, independent contractors, interns, and volunteers, with exceptions for certain agreements entered into by a seller of a business and in the franchise context.

According to the FTC, a sweeping ban is necessary because non-compete agreements drive down employee wages, stifle innovation, block entrepreneurs from starting new businesses, hamper competition, and harm consumers. The FTC claims nearly 30 million American workers are subject to non-competes, and non-competes suppress American wages by nearly \$300 billion per year. Detractors, including FTC Commissioner Christine S. Wilson in her [dissenting statement](#), question the business justifications and the FTC's legal authority for advancing such a rule.

The proposed rule was published in the Federal Register on January 8, 2023, and is now open for public comment until March 10, 2023. After the public comment period closes, a final version of the rule will be published, and could take effect 180 days later. Whether this exceptionally broad rule ever becomes effective remains to be seen, but employers should carefully monitor related developments.

Key Takeaways:

1. The FTC's proposed rule is essentially a nationwide ban on post-termination non-compete agreements.
2. The definitions in the proposed rule are broad and could apply to nearly all employers and workers.
3. The proposed ban could affect other employment-related agreements, such as non-solicits, non-disclosure, and forfeiture-for-competition agreements, but it is unclear to what extent.
4. The proposed law would require employers to individually rescind all existing non-compete agreements and to provide notice to current and former employees.
5. Whether the FTC has the authority to create the proposed rule remains to be seen. There are significant legal arguments against the FTC's authority and these challenges will likely be settled in court.
6. Employers should try to prepare for the potential adoption of the proposed rule, particularly by solidifying alternative means of protecting trade secrets and goodwill.

The Proposed Rule Essentially Bans All Post-Termination Non-Compete Agreements

The FTC's proposed rule would make it an illegal and "unfair method of competition" for an employer to:

- 1) enter into or attempt to enter into a non-compete with a worker;
- 2) maintain a non-compete with a worker; or
- 3) represent to a worker, under certain circumstances, that the worker is subject to a non-compete.

The proposed rule broadly defines a non-compete provision as any 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 also bans "functional" non-compete agreements, which are contractual terms that are "*de facto* non-compete clause[s]" because they have the effect of prohibiting workers from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the

employer. The rule includes two examples of “de facto” non-competes: (1) an overly-broad non-disclosure agreement that precludes an employee from finding new work; and (2) penalty clauses that require a departing employee to pay the employer for costs and fees not reasonably related to the costs incurred for training the worker.

The proposed rule would not extend to: (1) non-compete agreements entered into by a “substantial” owner, member, or partner in connection with the sale of a business; or (2) non-compete provisions in most franchisee-franchisor agreements. The rule defines “substantial owner” as someone who owns 25% or more of the business.

Potential Impact on Related Covenants

Although the rule does not expressly prohibit non-solicitation, non-disclosure, confidentiality, liquidated damages, training-repayment agreements, or intellectual property agreements, such agreements could be deemed “de facto” non-competes if written too broadly.

The rule’s application is unclear with respect to forfeiture for competition clauses, whereby an employee relinquishes the right to some compensation or benefit by engaging in post-employment competition. For example, many employee equity plans provide that an employee will forfeit or sell back equity if they compete. It is unclear whether a forfeiture for competition clause would be held to “prevent” a worker from competing and therefore qualify as a “de facto” non-compete agreement. The answer to this question may turn on whether the forfeiture is similar to the training fees described in the example above, or an advance on salary for work not-yet-performed.

Who Is Covered By the Proposed Rule? All Workers and Employers.

The proposed rule includes broad definitions of workers and employers. Under the rule, a covered “worker” includes all employees, independent contractors, externs, interns, volunteers, apprentices, and sole proprietors who provide a service to a client or customer, whether the position is paid or unpaid. The rule defines “employer” as any person or entity who hires or contracts with a worker to work for the person or entity. As many have pointed out, these definitions apply to approximately 99% of the U.S. workforce.

Retroactive Impact and Rescission of Existing Agreements

If the proposed rule takes effect, employers will be required to rescind all existing non-compete agreements, but not non-compete agreements with former employees that have, by their own terms, expired.

Under the rule, rescission of non-competes requires employers to notify every current and former employee individually – via email, letter, or other direct communication – that the non-compete provisions in their employment agreement is illegal and unenforceable. The rule provides model language that employers may use in these communications.

Potential Impact of Non-Compliance

Employers who violate FTC rules may face FTC civil enforcement actions. The FTC is empowered to bring civil enforcement actions against employers for violations of FTC rules. These enforcement actions can include civil penalties, injunctions, and consent judgments. In January 2023, the maximum civil penalty amount increased from \$46,517 to \$50,120 for violations of the relevant sections of the FTC Act. The FTC cannot bring criminal charges but its Criminal Liaison Unit may coordinate with the U.S. Department of Justice to help prosecute the worst FTC Act violators.

By way of example (or warning), the FTC recently filed complaints against several employers for enforcing non-competes that the FTC deemed unfair and likely to harm competition. In one case, the FTC obtained a consent order banning the employer from enforcing, threatening to enforce, or imposing non-competes against these employees, requiring the employer to provide copies of the consent order to current and former employees, and requiring the employer to notify new employees for the next decade that their employment is not subject to a non-compete and they may seek or accept a job with any company or employer.

The new rule does not provide workers with a private right of action so employers are unlikely to be sued by employees if they violate the ban on non-compete agreements.

Proposed Rule Supersedes Most State Laws

The proposed rule would supersede any state laws covering non-compete provisions, unless those laws afford greater protection to workers than the FTC's rule. Several states' laws impose restrictions on non-compete agreements. It remains to be seen whether these restrictions are considered more protective, or not. For example, is a state law that requires employers to pay an employee not to work more generous than a ban on non-competes?

Will This Rule Ever Take Effect?

The FTC will likely face significant legal challenges if/when this rule takes effect. Specifically, it is unclear whether the FTC has the power to define "unfair methods of competition" through notice and rulemaking. Further, under the "major questions"

doctrine, the U.S. Congress must speak clearly when empowering federal agencies to regulate issues of great national significance. The U.S. Supreme Court blocked OSHA's vaccination rules on these grounds in 2022, and may similarly hold that the FTC has overstepped its rule-making authority here.

What Happens Next?

The proposed rule is open for public comment until March 10, 2023. Interested parties may submit comments throughout that period, including through [this U.S. Government website](#). In its [supplement to the proposed rule](#), the FTC has requested comment on numerous issues, including:

1. Whether non-compete clauses between employers and senior executives, high-tech workers, physicians, highly-skilled workers, or high-salary employees should be subject to a different standards than with other workers. If so, what tests and salary thresholds should apply?
2. Whether the FTC has accurately assessed the benefits and costs of the proposed rule, including its impact on competition, wages, markets, economic growth, investment, employee training and retention, as well as the costs associated with complying with notifying employees of rescinded agreements, and revising employment agreements.
3. Whether employers have reasonable alternatives to non-compete clauses for protecting their investments in people and intellectual property, such as U.S. trade secret laws and appropriately tailored non-disclosure and non-solicitation agreements.
4. Whether non-compete agreements should be permitted in the sale of business context, and whether the proposed rule properly defines those circumstances.
5. Whether the FTC should adopt a rebuttable presumption that a non-compete violates the proposed rule instead of a categorical ban, and what the test for rebutting the presumption should be.

After the comment period, the agency will finalize the rule, and, 180 days after the final version is published, the rule will become effective.

Please contact your Gunderson attorney with questions or concerns regarding the FTC's proposed rule.

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