FTC PROPOSES SWEEPING BAN ON EMPLOYEE NONCOMPETE CLAUSES: WHAT EMPLOYERS NEED TO KNOW, PROPOSED ALTERNATIVES, AND OPPORTUNITY FOR PUBLIC COMMENT

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By: Lauren Norris Donahue, David C. Lindsay, Eugene C. Ryu, Erinn L. Rigney

The Federal Trade Commission (FTC) has kicked off 2023 by unveiling a Notice of Proposed Rulemaking (Proposed Rule) that would ban companies from entering into noncompete agreements with their workers and render void all existing post-employment noncompete agreements. The Proposed Rule represents a radical departure from long-standing federal and state precedent and marks a continued effort by both federal and state enforcers to eliminate the use of noncompetes in the labor market. A day prior to announcing the Proposed Rule, the FTC announced that it had filed complaints against, and entered into consent decrees with, three separate entities that rendered invalid noncompete provisions with thousands of workers.[1] The FTC has set forth potential alternatives to the Proposed Rule and invited public comment on both the Proposed Rule and those alternatives for the next 60 days. Below, we discuss:

- The nuts and bolts of the FTC's Proposed Rule.
- Alternatives included in the FTC's Proposed Rule.
- Likely challenges to the Proposed Rule.
- Opportunities for companies and employers to raise objections, concerns, and comments about the Proposed Rule.

THE PROPOSED RULE[2]

The Proposed Rule would supersede all applicable state laws, ban employers from entering into noncompete agreements with their employees, and render void all existing noncompete agreements. The Proposed Rule does not contain any exceptions for specific industries, and, if implemented, it will apply to all workers, including not only employees but also independent contractors, interns, volunteers, and other workers regardless of their rate of pay or position. The only exception to the ban is in the limited and narrow context of the sale of a business entity or ownership interest, but even then, a noncompete would only be permitted between the buyer and a *"substantial owner of"* or a *"substantial partner in"* the business being sold. "Substantial" ownership is defined as a 25 percent ownership interest, which is a much higher threshold than many states currently require and could mean that minority owners cannot be subject to a sale-of-business noncompete.

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The Proposed Rule defines a noncompete clause 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.” Literally applying this plain language arguably allows for position- or role-based restrictions that prohibit an employee from working in the same or similar role for a competitor, because such restrictions do not “prevent” employees from “seeking or accepting employment” with competitors in a blanket manner. Further, the Proposed Rule does not explicitly reference customer nonsolicitation restrictions (although they are mentioned in the accompanying guidance), which even when narrowly tailored can still meaningfully impact a sales employee's choice of new employer. However, the Proposed Rule also sets forth a “functional test” to determine if contractual terms other than true noncompete clauses fall within the noncompete definition. The “functional test” framework provides the FTC a lot of gray area and wiggle room to determine that all manner of restrictions, including position- or role-based restrictions and client nonsolicitation restrictions, are prohibited.

In perhaps what is the most far-reaching provision of the Proposed Rule, the FTC would require employers with existing noncompete agreements, as defined in the Proposed Rule, to rescind such provisions and provide individualized notice of such rescission directly to each worker following publication of the final rule. This requirement would extend not only to current workers, but also to those former workers for whom the employer has “readily available” contact information.

The FTC claims authority for the Proposed Rule under Section 5 of the Federal Trade Commission Act (FTC Act), which allows the agency to police unfair methods of competition. Section 5 declares “unfair methods of competition” to be unlawful, and further directs the FTC “to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce.” Section 6(g) of the FTC Act authorizes the FTC to “make rules and regulations for the purpose of carrying out the provisions of” the FTC Act, including the FTC Act's prohibition of unfair methods of competition.

According to FTC Chair Lina Khan, “Non-competes block workers from freely switching jobs, depriving them of higher wages and better working conditions, and depriving businesses of a talent pool that they need to build and expand…by ending this practice, the F.T.C.'s proposed rule would promote greater dynamism, innovation and healthy competition.”

ALTERNATIVE PROPOSALS

The Proposed Rule sets forth a number of alternative proposals on which the FTC is seeking public comment. The alternatives primarily address two categorical questions: (1) whether the rule should impose a categorical ban on noncompete clauses or a rebuttable presumption of unlawfulness, and (2) whether the rule should apply uniformly to all workers or whether there should be exemptions or different standards for different categories of workers.

SIGNIFICANT CHALLENGES LIKELY

We anticipate that the Proposed Rule will face significant pushback from the business community during the public comment period, and it will certainly face legal challenges in court if implemented.[3] First, we expect the Proposed Rule will face constitutional challenges. Second, we anticipate challenges to the FTC's authority to

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issue a regulation with such a far-reaching scope and novel application of Section 5 of the FTC Act. Third, we also anticipate that courts will carefully scrutinize the scholarship that the FTC relies on to support its position that noncompete agreements have an anti-competitive impact on the marketplace—scholarship that is far from definitive or determinative.[4]

The FTC's effort follows recent increased state-level activity limiting the use and scope of noncompete agreements, and we anticipate that we will continue to see federal agencies engaged in additional rulemaking to address perceived inequitable bargaining power between employees and employers. In fact, the FTC and National Labor Relations Board recently announced an information-sharing agreement that foreshadowed this activity.[5]

PUBLIC COMMENTS ALLOWED FOR NEXT 60 DAYS

The public will be allowed to submit comments on the proposal for 60 days, after which the agency will move to make it final. Dissenting FTC Commissioner Christine Wilson warned that "[s]takeholders should note that *this solicitation for public comment is likely the only opportunity they will have to provide input not just on the proposed ban, but also on the proposed alternatives.* For this reason, I encourage all interested parties to respond fully to all parts of the NPRM's solicitation of public comments."[6] The rule would take effect 180 days after the final version is published.

Companies should discuss the impact the Proposed Rule would have on their business with counsel and consider submitting a comment letter to the FTC. Regardless of whether the Proposed Rule is ultimately adopted, companies should continue to be vigilant when using noncompete clauses in employment agreements and understand the increased risk these clauses pose in today's enforcement environment.

The lawyers of K&L Gates' Labor, Employment, and Workplace Safety practice and Antitrust, Competition, and Trade Regulation practice regularly counsel clients on a wide variety of issues related to noncompete clauses and are well-positioned to provide guidance and assistance to clients on this significant development.

FOOTNOTES

[1] Press Release, Fed. Trade Comm'n, FTC Cracks Down on Companies That Impose Harmful Noncompete Restrictions on Thousands of Workers (Jan. 4, 2023), FTC Cracks Down on Companies That Impose Harmful Noncompete Restrictions on Thousands of Workers | Federal Trade Commission.

[2] Fed. Trade Comm'n, Non-Compete Clause Rulemaking (Jan. 5, 2023), https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking [hereinafter FTC Notice].

[3] *See* Fed. Trade Comm'n, Dissenting Statement of Commissioner Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule (Jan. 5, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf [hereinafter Wilson Statement].

[4] FTC Notice, *supra* note 2.

[5] *See* Gene Ryu, Katie Staba & Jonathan Rue, *FTC and NLRB Enter Into an Information Sharing Agreement as a*

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Likely Precursor to New Enforcement Activity, K&L GATES LLP CONSUMER PRODS. WATCH (Dec. 20, 2022), https://www.consumerproductslawwatch.com/2022/12/ftc-and-nlrb-enter-into-an-information-sharing-agreement-as-a-likely-precursor-to-new-enforcement-activity/.

[6] Wilson Statement, supra note 3 (emphasis in original).

KEY CONTACTS



LAUREN NORRIS DONAHUE
PARTNER

CHICAGO
+1.312.807.4218
LAUREN.DONAHUE@KLGATES.COM



DAVID C. LINDSAY
MANAGING PARTNER, RALEIGH OFFICE

RALEIGH, CHARLOTTE
+1.919.743.7304
DAVID.LINDSAY@KLGATES.COM



EUGENE C. RYU
PRACTICE AREA LEADER - LITIGATION

LOS ANGELES, SAN FRANCISCO
+1.310.552.5035
GENE.RYU@KLGATES.COM



ERINN L. RIGNEY
PARTNER

CHICAGO
+1.312.807.4407
ERINN.RIGNEY@KLGATES.COM

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