

FTC PROPOSES RULE TO PROHIBIT NONCOMPETE CLAUSES

On January 5, 2023, the Federal Trade Commission ("**FTC**") published a Notice of Proposed Rulemaking ("**Proposed Rule**") that would prohibit employers from entering into or imposing noncompete clauses on their employees.¹ The lengthy Proposed Rule comes one day after the FTC obtained three settlements from companies over their use of noncompetes, arguing these clauses constitute an unfair method of competition under Section 5 of the FTC Act ("**Section 5**"). The FTC voted 3-1 to publish the Proposed Rule with Commissioner Wilson dissenting. The Proposed Rule continues the FTC's focus on labor issues; however, it runs counter to decades of court decisions where noncompetes have been evaluated on a case-by-case basis, considering the reasonableness of the clause's duration, geographic scope, and business justifications.

THE FTC'S PROPOSAL

For years, noncompete agreements have been legal under federal precedent and most states' contract law principles when reasonable and tailored in scope and duration. The Proposed Rule would upend this business practice.

The FTC preliminarily found noncompetes were unfair methods of competition under Section 5 for three reasons: (i) they restrict conduct that negatively affects competitive conditions; (ii) they are exploitative and coercive at the time of contracting; and (iii) they are exploitative and coercive at the time of the worker's potential departure from the employer. The Proposed Rule follows the FTC change in policy statement under Section 5 in November 2022 (previous client alert can be found [here](#)), an expansive interpretation of Section 5 that the FTC unilaterally broadened on its own without Congressional authorization.

¹ See *Non-Compete Clause Rule*, (Jan. 5, 2023) (to be codified at 16 C.F.R. § 910), available at https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf; see also Press Release, Fed. Trade Comm'n, *FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition* (Jan. 5, 2023), available at https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition?utm_source=govdelivery.

Based upon its research and "years of activity by the [FTC] related to noncompete clauses and their effect on competition," the Proposed Rule outlines numerous purported harms caused by noncompetes. These harms include lower pay to not just those employees covered by noncompetes, but to other workers in the labor market. Noncompetes increase consumer prices and industry consolidation. The Proposed Rule also claims that noncompetes stymie competition by foreclosing competitors from accessing key talent, decreasing innovation, and making entrepreneurship more difficult.

The proposed prohibition includes entering into or attempting to enter into a noncompete, maintaining a noncompete, or even representing that a worker is subject to a noncompete. The Proposed Rule would apply to independent contractors and any paid or unpaid employees. Additionally, the FTC would require employers to rescind existing noncompetes and actively inform workers that these clauses are no longer in effect. The FTC recognizes one exception, which applies to an owner of a business being sold; however, this only applies to substantial owners, meaning that the owner holds at least 25% ownership in the entity. Beyond the effects of the Proposed Rule as a whole, the 25% threshold is a specific issue that we expect will be of interest to the business community and should garner attention in comments to the Proposed Rule.

The FTC states that the proposed prohibition would not necessarily apply to other types of employment restrictions like non-disclosure agreements, but it caveats that the Proposed Rule could apply to restrictions that "are so broad in scope that they function as noncompetes" (e.g., a partnership withdrawal agreement that requires departing partners to pay their old firm 100% of the fees earned from clients for the year following their departure).

In the Proposed Rule, the FTC requests input on several issues, such as whether there should be a categorical ban on noncompetes or a rebuttable presumption of unlawfulness; and whether the rule should apply uniformly or if there should be exemptions or different standards for different categories of workers. The FTC acknowledges in the Proposed Rule that senior executives do not face the same burdens as low-wage workers and are uniquely positioned to have more power in negotiating their terms of employment.

The actions taken by the FTC are a continuation of President Biden's *Executive Order on Promoting Competition in the American Economy*,² which emphasized his concerns regarding unfair restrictions on American workers and encouraging the FTC to limit or eliminate noncompetes through the rulemaking process (previous client alert can be found [here](#)). The FTC claims that noncompete clauses affect one in five American workers and that eliminating noncompetes would increase wages \$300 billion annually. Further, a 2014 study cited by the FTC found 35-38% of workers have at one time worked under a noncompete. A 2021 study found 53% of workers subject to noncompetes were hourly employees.

As Chair Lina Khan states in an opinion piece published in the New York Times following the Proposed Rule, the FTC's proposal is based on "a body of empirical

² Exec. Order No. 14,036, 85 Fed. Reg. 36,987 (July 9, 2021), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/>.

research show[ing] that [noncompetes] inflict major harm across the economy," including harms to those employees not even bound by noncompetes.³ Based on the research that the FTC has collected and its experience on the topic, Chair Khan believes "the evidence to date suggests that noncompetes suppress wages, reduce competition and keep innovative ideas from breaking into the market." The Proposed Rule also relies on the fact that some states have implemented laws regulating the use of, or rendering void, certain employment noncompetes.

COMMISSIONER WILSON'S DISSENT

In her dissent, Commissioner Wilson states that the Proposed Rule represents a radical departure from hundreds of years of legal precedent.⁴ Her dissent stresses the FTC's failure to recognize the procompetitive justifications of noncompetes. When it comes to the FTC being experts in the field, she notes their "little enforcement experience" occurred only in the last week and fails to demonstrate harm to consumers and competition. Those recent cases involve security companies⁵ and glass container manufacturers⁶ agreeing to drop noncompete agreements from employee contracts. In the case against two security companies, the FTC alleged that the owners required their security guards to sign a noncompete clause prohibiting them from working for a competing business within a 100-mile radius for two years after leaving and included a \$100,000 penalty for violations of the noncompete. In the other case, the two largest glass container manufacturers, who operated in a highly concentrated market with significant barriers to entry, used noncompetes that banned employees from performing related services for up to two years.

Additionally, Commissioner Wilson points out in her dissent that although the majority cited many studies, the studies resulted in mixed findings. She also articulates that many of the cases cited were unsuccessful (all of the noncompete clauses in one footnote of the Proposed Rule, for example, were all found to be enforceable), with some courts rejecting the argument that noncompetes are *per se* unlawful.⁷ As she puts it, "[t]hese early examples of cherry-picking evidence that conforms to the narrative provide little confidence in the integrity of the rulemaking process or the ultimate outcome."

Commissioner Wilson expects there to be successful legal challenges to the Proposed Rule and outlines the grounds upon which parties may challenge the FTC's Proposed Rule. Commissioner Wilson notes (1) the FTC does not have the authority to promulgate competition rulemaking; (2) the FTC's authority will likely be challenged under the major-questions doctrine, which the Supreme Court applied in *West Virginia v. EPA*; and (3) the FTC's authority could be called into

³ Lina Khan, *Lina Khan: Noncompetes Depress Wages and Kill Innovation*, N.Y. Times (Jan. 9, 2023), available at <https://www.nytimes.com/2023/01/09/opinion/linakhan-ftc-noncompete.html?referringSource=articleShare>.

⁴ *Dissenting Statement of Commissioner Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule*, Fed. Trade Comm'n (Jan. 5, 2023), available at https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf.

⁵ See *In the Matter of Prudential Sec., Inc.*, Docket No. 221-0026 (Dec. 28, 2022), available at https://www.ftc.gov/system/files/ftc_gov/pdf/2210026prudentialsecurityacco.pdf.

⁶ See *In the Matter of Ardaugh Group S.A.*, Docket No. 211-0182 (Dec. 28, 2022), available at https://www.ftc.gov/system/files/ftc_gov/pdf/2110182ardaghacco.pdf; *In the Matter of O-I Glass, Inc.*, Docket No. 211-0182 (Dec. 28, 2022), available at https://www.ftc.gov/system/files/ftc_gov/pdf/2110182o-iglassacco.pdf.

⁷ See, e.g., *Snap-On Tools Corp. v. Fed. Trade Comm'n*, 321 F.2d 825, 837 (7th Cir. 1963) ("Restrictive clauses of this kind are legal unless they are unreasonable as to time or geographic scope; but even if this restriction is unreasonable as to geographic scope, we are not prepared to say that it is a *per se* violation of the antitrust laws").

question under the non-delegation doctrine. Pursuant to the major-questions doctrine, a court will ask whether Congress conferred power that an agency is asserting by looking at the "history and the breadth of the authority that the agency has asserted, and the economic and political significance of that assertion, provide a reason to hesitate before concluding that Congress meant to confer such authority."⁸ The non-delegation doctrine is the principle that Congress cannot delegate its legislative power to another branch of government.

NEXT STEPS

Once the final rule is published in the Federal Register, the rule would go into effect after 180 days. Lengthy litigation is expected shortly thereafter, if not sooner. Commissioner Wilson highlights the importance of submissions during the 60-day comment period as this period is likely the only opportunity for public input before the Commissioners vote on a final rule.

Commissioner Wilson is not the only one who disagrees with the FTC's decision to publish the Proposed Rule. The U.S. Chamber of Commerce called the rulemaking "blatantly unlawful" and notes that Congress "has never delegated the FTC anything close to the authority it would need to promulgate such a competition rule."⁹

⁸ 142 S. Ct. 2587, 2608 (2022).

⁹ Press Release, U.S. Chamber of Com., *The FTC's Noncompete Rulemaking is Blatantly Unlawful* (Jan. 5, 2023), available at <https://www.uschamber.com/finance/antitrust/the-ftcs-noncompete-rulemaking-is-blatantly-unlawful>.

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