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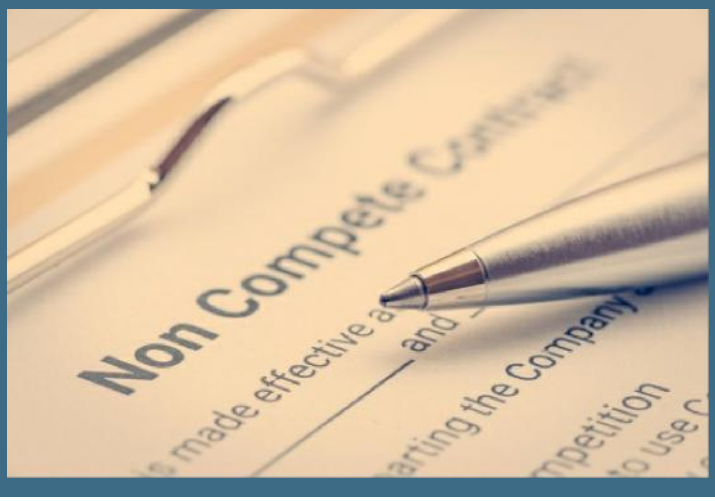

Proposed FTC Rule Would Ban Non-Competes

Based on its preliminary finding that non-compete clauses between businesses and their work force constitute unfair methods of competition in violation of the Federal Trade Commission Act, the Federal Trade Commission has proposed a new rule that would outlaw an employer from imposing non-compete clauses on workers, broadly defined under the proposed rule to include not only employees, but also independent contractors, interns, and volunteers. The proposed rule is substantially similar to a statutory provision in California that, subject to limited exceptions, voids "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind. Code §§ 16600-16603." California Business and Professional

If enacted, the proposed rule would not only prohibit employers from entering into or attempting to enter into a non-compete with a worker

but would also require employers to rescind any such agreements that it has in place with its existing workforce. The proposed rule does not address precisely how that rescission would take place, including whether businesses would be entitled to return of any consideration paid to the worker in exchange for such a clause. The sole exception under the proposed rule would be for a person either selling a business or otherwise disposing of all ownership in the business, or a person who is selling all or substantially all of a business's operating assets, but this exception would only apply to workers who were already a substantial owner, member, or partner in the business at the time the non-compete was entered into.

The proposed rule would focus its efforts more on substance over form, with the *effect* of the contractual language controlling over how the term is referred to in a contract. For example, non-disclosure agreements may remain permissible (to the extent they comply with existing requirements), unless those clauses are drafted in such a way as to be "so unusually broad in scope that they function" as non-compete clauses. However, the proposed rule provides no guidance as to how broad a clause would need to be before it is considered "so unusually broad" as to be prohibited. Contractual terms that would require a worker to pay the business or a third-party for training costs if the working relationship is terminated would be prohibited unless the required payment is reasonably related to the costs the business incurred in training the worker.

Several states, including Minnesota, allow noncompete agreements (either by statute or judicial action) provided that the restrictions on the worker are no broader than to protect the legitimate interests of the business and do not otherwise impose unnecessary hardship on the worker. Additionally, Minnesota's "blue-pencil doctrine" allows the Courts to intervene and reform noncompete clauses that are overly restrictive, thereby still protecting the business's interests. The proposed rule, however, threatens to short circuit this jurisprudence, as it would "supersede any State statute, regulation, order, or interpretation to the extent that such statute, regulation, order, or interpretations is inconsistent with [the proposed rule]." Put another way, the proposed rule would overturn nationwide jurisprudence that allows a business to protect its legitimate interests through the use of noncompete provisions, unless doing so in connection with the sale of a business.

Public comment is now open on the rule and will remain so until March 10, 2023. After the public-comment period closes, the FTC will review the comments and may make changes before the rule is finalized. Even after the rule is finalized, it is likely that the rule will be challenged in the judicial system, which may postpone the effective date of the rule. By way of illustration only, the U.S. Chamber of Commerce has released a statement that the proposed rule is "blatantly unlawful" and the FTC's efforts to "ban noncompete clauses

in all employment circumstances [would] overturn [] well-established state laws which have long governed their use and ignore [] the fact that, when appropriately used, noncompete agreements are an important tool in fostering innovation and preserving competition." Additionally, while the FTC has claimed that it is "empowered, among other things to [] prevent unfair methods of competition … [and] prescribe rules defining with specificity acts or practices that are unfair or deceptive, and establishing requirements designed to prevent such acts or practices," recent decisions from the United States Supreme Court leave the FTC's authority an open question absent explicit Congressional language. *See AMG Cap. Mgmt. v. FTC*, 141 S. Ct. 1341, 1349 (2021).

It also is an open question whether (and how) the proposed rule would interact with other statutory provisions, including Minnesota's adoption of the Uniform Trade Secret Act (codified at Minn. Stat. §§ 325C.01.08) or its federal counterpart, the Defend Trade Secrets Act of 2016 (18 U.S.C. § 1836, *et seq.*). At least one court, reviewing California's statutory provision which is similar to the proposed rule, has provided some language that may be comforting for businesses, noting that while the California statue "bars a court from specifically enforcing (by way of injunctive relief) a contractual clause purporting to ban a former employee from soliciting former customers to transfer their business away from the former employer to the employee's new business," courts were still empowered to enjoin *tortious* conduct as violative of either the Uniform Trade Secrets Act or other statutes. *See Retirement Group v. Galante*, 176 Cal.App.4th 1226, 1238 (2009) (emphasis omitted).

In the meantime, businesses should ensure that they are taking steps to protect their trade secrets and other confidential information; ensure that any employment contracts with their current work force include a severability clause, which would help keep other provisions of the contract in force in the event the proposed rule goes into effect; and, if necessary, work with counsel to draft a narrow contractual provision that would not rise to the level of a non-compete that would be prohibited by the proposed rule.

The attorneys at Madigan, Dahl & Harlan, P.A. will continue to monitor the FTC's proposed rule and its potential implementation and stand ready to assist businesses in this and other labor & employment matters.

This communication is not intended to and does not constitute legal advice. For specific questions, please contact one of the attorneys at Madigan, Dahl & Harlan, P.A.

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