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The Future of Noncompetes in the Wake of the Proposed FTC Ban

Presented By:

Benjamin I. Fink
Neal F. Weinrich
Carson L. Modrall
Berman Fink Van Horn P.C.
bfink@bfvlaw.com
nweinrich@bfvlaw.com
cmodrall@bfvlaw.com

www.bfvlaw.com

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Agenda

- 1) How We Got Here
- 2) What Does the FTC's Proposed Rule Do?
- 3) What is the Current Status of the Rule?
- 4) What is the Likelihood the Rule is Implemented?
- 5) What Should Employers Do Now?

How We Got Here



How We Got Here

Jimmy John's investigation (2014) and settlement (2016)

- Noncompete clause required that for 2 years after the worker leaves their job, the worker may not perform services for any business which derives more than ten percent of its revenue from selling sandwiches located within 3 miles of any of the chain's locations
- Investigated by New York & Illinois Attorney General; ultimately a settlement was reached





2016: Obama Administration

- Treasury Report
- White House Report
- Call to Action

2018: FTC

- Opens door to changes re: noncompetes and is pushed by members of Congress

2020: FTC: First Workshop

2020: Biden Administration

- Platform includes noncompete reform

2021: Biden Administration: Executive Order

2021: FTC

- Second Workshop (w/ DOJ)

2022: FTC

- Issues CIDs
- MOU with NLRB
- Strategic Plan

Takeaway:

Legislative and regulatory activity targeting non-compete enforceability is rapidly evolving, and companies should monitor new developments.

Long-brewing Regulatory & Legislative Background

January 2023

• January 4, 2023

- FTC enforcement actions
 - *In re Prudential Security*
 - *In re O-I Glass*

• January 5, 2023

- FTC reveals the proposed rule banning the use of noncompetes in employment agreements.

Takeaway:

Enforcement actions can occur, and likely will continue occurring, regardless of the outcome of the Rule.

State of the Union 2023



What Does the FTC's Proposed Rule Do?



What does the FTC's Proposed Rule Do?

“It is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or represent to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause.”

16 CFR § 910.2(a) (proposed).

What does the FTC's Proposed Rule Do?

- “Worker” is defined broadly:
 - A natural person who works, whether paid or unpaid, for an employer. The term includes, without limitation an:
 - Employee;
 - Individual classified as an independent contractor;
 - Extern or intern;
 - Volunteer;
 - Apprentice;
 - or sole proprietor who provides a service to a client or customer.
 - The term worker does not include a franchisee in the context of a franchisee-franchisor relationship; however, the term worker includes a natural person who works for the franchisee or franchisor.

16 CFR § 910.1(f) (proposed).

What does the FTC's Proposed Rule Do?

MAIN ELEMENTS TO THE PROPOSED RULE:

- 1) **Prohibits** the use of noncompetes in employment agreements at all levels, for all workers;
- 2) Explicitly defines “noncompete” as including *de facto* noncompete clauses;
- 3) Requires employers to **notify** their workers of the prohibition and to **rescind** any existing noncompete provisions in effect;
- 4) **Supersedes** state law on noncompetes.

What is a “de facto” noncompete?

- **Great question!**

A provision that

“has the effect of prohibiting 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.”

- A **non-disclosure agreement** between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field.
 - *But reasonable non-disclosure clauses, customer non-solicits, and employee non-solicits are **not** prohibited*
- A requirement that the worker must **repay training costs** where the required payment is not reasonably related to the costs the employer incurred for training the worker.
- Disproportionately **high liquidated damages provisions** for violation of other restrictive covenants, or forfeiture of benefits provisions.

Remember: “de facto” noncompetes are not limited to the examples provided by the FTC

Takeaway:
Scrutinize *all* of your restrictive covenants and agreements purporting to affect workers post-employment

Examples of
de facto
noncompetes
provided by
the FTC

Rescission Requirements

- Employers must rescind noncompetes by the compliance date
- Employers must notify employees that the non-compete is no longer in effect
 - Cannot be a mass communication
 - Must be on paper or digital format (e-mail or text message)
- Notice must be given to current and former employees

FTC's Sample Notice

A new rule enforced by the Federal Trade Commission makes it unlawful for us to maintain a non-compete clause in your employment contract. As of [DATE 180 DAYS AFTER DATE OF PUBLICATION OF THE FINAL RULE], the non-compete clause in your contract is no longer in effect. This means that once you stop working for [EMPLOYER NAME]:

- You may seek or accept a job with any company or any person—even if they compete with [EMPLOYER NAME].
- You may run your own business—even if it competes with [EMPLOYER NAME].
- You may compete with [EMPLOYER NAME] at any time following your employment with [EMPLOYER NAME].

The FTC's new rule does not affect any other terms of your employment contract. For more information about the rule, visit [\[link to final rule landing page\]](#).

Does the Rule Apply to All Noncompetes?

- **No, there are exceptions:**

- Narrow Sale of Business Exception (Only 25% owners)
- Industries to which Section 5 of the Federal Trade Commission Act expressly does not apply
 - Banks; federal credit unions; savings and loan institutions; common carriers; air carriers and foreign air carriers; and persons and businesses subject to the Packers and Stockyards Act
- Non-profit businesses because the FTC's authority does not extend beyond a company "which is organized to carry on business for its own profit or that of its members"
 - This could exclude health care systems, hospitals, and other organizations.

*What's the Current Status of the Rule?
How Likely Is It to Take Effect?*

When would the Rule take effect?

- 
- January 5, 2023 – The FTC announced the proposed Rule
 - January 19, 2023 – The FTC’s formal Notice of Proposed Rule Making is published in the Federal Register
 - March 20, 2023 – The 60-day notice and comment period closes
 - *Note: A group of wide-ranging industry organizations have jointly requested a 60-day extension*
 - *To date, 11,923 comments have been received*
 - FTC may finalize the rule or issue a revised proposed rule
 - Office of Information and Regulatory Affairs reviews impact of rule
 - Final rule is published in Federal Register (likely will have an effective date of 60 days after publication to allow for Congressional review)
 - Congress can review rule during this period
 - Employers have 180-day period to comply with rule following its publication

Potential Challenges: Can the FTC do this?

- The Rule will almost certainly be challenged in court
- Potential Challenge Bases:
 - FTC's Statutory Authority to Regulate Noncompetes
 - Major Questions Doctrine
 - Non-Delegation Doctrine
- **Jan. 5, 2023:** U.S. Chamber of Commerce has promised to challenge the rule:
 - "Today's actions by the Federal Trade Commission to outright ban noncompete clauses in all employer contracts is blatantly unlawful. Since the agency's creation over 100 years ago, Congress has never delegated the FTC anything close to the authority it would need to promulgate such a competition rule. The Chamber is confident that this unlawful action will not stand."
- **Feb. 14, 2023:** The House Judiciary Committee Chairman issued a letter to FTC chair claiming the rule exceeds the agency's authority

¹<https://www.uschamber.com/finance/antitrust/the-ftcs-noncompete-rulemaking-is-blattantly-unlawful>

Federal Legislative Activity

- **Two bipartisan bills have been reintroduced in this session**
- **The Workforce Mobility Act of 2023**
 - General ban on noncompetes that is similar in scope to the FTC's rule
 - Exceptions: 1) noncompetes entered into sellers of a business; 2) noncompetes that are one-year or less in duration in severance agreements with senior executive officials in the context of a sale of a business; and 3) noncompetes in the context of a partnership dissolution
- **Freedom to Compete Act**
 - Would prohibit employers from entering into or enforcing noncompetes with a non-exempt employee under the FLSA.

State-Level Efforts to Narrow Noncompetes

- Wage threshold
 - At least 10 states utilize a wage threshold to determine who can be bound by a noncompete

State	Not bound if making
Colorado	\$101,250 or \$865.38 weekly
D.C.	Under \$150,000
Illinois	Under \$75,000
Maine	400% of poverty level
Maryland	\$15/hour or \$31,200 annually
Massachusetts	Nonexempt under FLSA
Nevada	Hourly wage

State	Not bound if making
New Hampshire	\$14.50/hour (excluding tip-based employees)
Oregon	\$100,533 or under
Rhode Island	250% of poverty level or nonexempt under FLSA
Virginia	Under the average weekly wage in Virginia
Washington	\$100,000 for employees; \$250,000 for independent contracts

State-Level Efforts to Narrow Noncompetes

Takeaway:

Employers with employees in multiple jurisdictions must stay apprised of ongoing changes.

- Enforceability triggered by cause of termination
 - Several states will not enforce a noncompete against an employee terminated without cause, or enforceability depends in part on termination
- Notice requirements
 - Employers are required to provide *advance* notice of noncompete provisions to new hires and to current employees before the provision takes effect
 - Can require express notice/advice to seek an attorney to review the non-compete
 - Can be enforced with fines and/or voiding the noncompete
- Limited effect of forum selection clauses/choice of law provisions to find favorable noncompete law

What now?



What Should Employers Be Doing?

- Review agreements to make sure they are narrowly tailored.
- Evaluate if your company is using noncompetes appropriately with its employees, and avoid using noncompetes with low-wage workers.
 - Regardless of the outcome of the Rule, the FTC is treating noncompetes as anticompetitive and initiating enforcement actions.
- Reevaluate the wording of the nondisclosure covenants your company uses.

What Should Employers Be Doing?

- Evaluate the enforceability of other restrictive covenants (including customer nonsolicits) under applicable state law.
- Review steps being taken to protect trade secrets and other sensitive and confidential information.
- Be cognizant of who has access to highly sensitive information given the looming FTC rule.
- Be mindful of the impact of the looming rule on various contracts and transactions.

Thank You



BERMAN FINK VAN HORN
ATTORNEYS AT LAW

Benjamin I. Fink,
Neal F. Weinrich
& Carson L. Modrall

Email: bfink@bfvlaw.com; nweinrich@bfvlaw.com; and cmodrall@bfvlaw.com

Phone: 404.261.7711

bfvlaw.com