GROOM LAW GROUP

Publications

With Proposed Non-Compete Ban, the FTC Joins the Executive Compensation Regulatory Landscape

ATTORNEYS & PROFESSIONALS

William Fogleman
wfogleman@groom.com
202-861-6619

Jeffrey W. Kroh
jkroh@groom.com
202-861-5428

Jenna Russell
jrussell@groom.com
202-861-5411

PUBLISHED
02/15/2023

SOURCE
Groom Publication

SERVICES
Employers & Sponsors
- Executive Compensation Programs
- Fiduciary & Plan Governance

Employers are accustomed to following rules related to executive compensation from the DOL, IRS, and SEC. It may be time to add a new acronym to the list – the Federal Trade Commission ("FTC").

On January 5, 2023, the FTC proposed a new federal antitrust regulation that would ban almost all non-compete agreements for employees. Citing authority under Section 5 of the FTC Act, the rule asserts that employee non-compete clauses amount to an "unfair method of competition." If enacted in its current form, the rule would broadly prohibit employers from entering into non-competes with workers across all industries and income levels – including those in the C suite.

Substantive Scope of the Ban

The proposed rule broadly defines a non-compete clause as "a contractual term between an employer and 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 term "worker" is similarly broad, defined as anyone who works, whether paid or unpaid, for an employer, including employees, independent contracts, externs, interns, volunteers, and apprentices. Although the proposed rule provides a limited exception for non-compete agreements with a person who is selling or otherwise transferring ownership of a business entity, or its operating assets, this exception likely would not be relevant for most employment-based non-competes. The proposed rule would preempt any inconsistent state or local laws, except where the state or local rules provide greater employee protections against non-compete agreements.

While the rule purports to only ban non-compete clauses, other types of employment-related restrictive covenants may be so broad in scope that they are also prohibited under the proposed rule. These could potentially include non-disclosure agreements and confidentiality provisions. Customer non-solicitation agreements and no-recruitment agreements, often provisions in employment contracts to prevent poaching an employer's business after leaving the company, could also be prohibited under the proposed rule if not carefully drafted to ensure that it does not prohibit the worker from seeking or accepting employment in the same field. Employers should

verify that such provisions are drafted to be only as narrow as required to protect actual trade secrets and confidential information.

The proposed rule would apply to all non-compete clauses, both prospectively and retroactively. If the proposed rule is enacted, employers must rescind all existing non-compete agreements and notify all impacted current and former employees that their non-compete clauses are no longer in effect. The proposed rule provides model language that would satisfy the notice requirement, as well as a safe harbor for employers who comply with the rescission and notice requirements in a timely manner. To meet the safe harbor, companies must: (i) identify and rescind all non-compete agreements, including any de facto non-compete provisions, within 180 days of enactment; and (ii) provide proper notice to all impacted individuals within 45 days. The proposed rule requires that "individualized communication" be provided to each current and former employee, so long as the worker's contact information is "readily available."

Considerations for Employers

While often an important component of employment agreements, non-compete clauses and other restrictive covenants are found in all sorts of executive compensation arrangements, including long-term incentive awards and nonqualified deferred compensation plans. If the proposed rule is finalized, employers would need to broadly review all restrictive covenants found in all of their compensation arrangements to confirm whether the restrictions are prohibited. Thus, compliance with the notice requirement could create a logistical nightmare for many employers. Even with employee contact information readily available, the process of sending proper notice before the 45-day deadline will be a heavy lift for many companies.

In addition, many employers offer departing executives severance in exchange for agreeing not to compete. These arrangements would be prohibited under the proposed rule, depriving employers of a popular tool for incentivizing "good leaver" behavior following termination. In addition, in many cases, it will be unclear whether an executive currently covered under an arrangement would remain contractually entitled to the severance payments after the non-compete clause has been rescinded. If the proposed rule is finalized, employers will have to consider whether their severance promises are still enforceable when the consideration for them (i.e., the promise not to compete) can no longer be provided.

Next Steps and Questions Over FTC Authority

Despite the significance of this announcement, the proposed rule has to clear several hurdles before adoption. On January 19, 2023, the notice was formally published in the *Federal Register*, triggering a 60-day public comment period for interested parties to submit concerns on the proposed regulation. The comment period will end on March 20, 2023. The agency will then review public comments and possibly make changes before finalizing the rule. Notably, the FTC is seeking public comment as to whether the rule should differentiate between low-wage workers and high earners.

If enacted in its current form, the rule is certain to prompt litigation. The controversy hinges on whether Section 5 of the FTC Act endows the agency with the authority to regulate unfair methods of competition outside the scope of consumer protections. Many argue that such an expansive read of Section 5 violates the Constitution.

Although the 1973 D.C. Circuit Court of Appeals case, *National Petroleum Refiners Ass'n. v. F.T.C.*, held that the FTC has the authority to enact "substantive rules" about what constitutes unfair methods of competition, critics of the proposed non-compete ban counter that the *National Petroleum* case holding created a narrow rule and does not provide authority for the FTC to pass broad sweeping regulations that would impact the economy.

Those opposed to the non-compete ban also point to the Supreme Court's 2022 decision in *West Virginia v. Environmental Protection Agency*, which applied the "major question doctrine" to strike down a regulation on the basis that the Environmental Protection Agency did not possess "clear congressional authority" to promulgate such a rule.

The attorneys at Groom Law Group will continue to monitor the progress of the proposed FTC rule and will provide updates as they become available.