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Employment Law Advisory:
FTC Proposes Nationwide Ban on Non-Compete Agreements

On January 5, 2023, the Federal Trade Commission (FTC) issued a Notice of Proposed Rulemaking (NPRM) to prohibit employers from entering into non-compete clauses with their employees, a significant move that would impact millions of workers nationwide.

The FTC states that about 20% of American workers are bound by these restrictive covenants and claim that they negatively impact wages, competition, and innovation. The FTC also asserts that its proposed rule could increase annual wages by up to $300 billion. The proposed rule extends to all paid and unpaid workers and requires companies to rescind existing non-compete agreements within 180 days of publication of the final rule.

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The Proposed Rule

The NPRM states that it is an "unfair method of competition" for an employer to enter into or maintain "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."

The rule also prohibits an employer from telling a worker that they are subject to a non-compete clause without a "good faith basis to believe that the worker is subject to an enforceable non-compete clause." This language suggests that some non-compete clauses are enforceable, but nothing in the proposed rule "saves" or grandfathers in any existing non-compete agreements, regardless of merit or, using the FTC's own language, a company's "good faith basis to believe" that its existing non-compete is enforceable. It exempts only non-compete agreements with individuals who own a minimum of 25% of a business which they are selling, or with a franchisee. In other words — the FTC's proposal precludes non-competes unless the individual has a financial interest at stake.

The rule also includes a rather subjective test for determining whether a contractual term is considered an unenforceable non-compete, providing examples:

- "[a] non-disclosure agreement … is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer;" or

- "[a] contractual term … requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker."

While the proposed rule does not expressly prohibit non-solicitation, non-disclosure and intellectual property agreements with employees, those agreements could be deemed impermissible non-competes if they are deemed to be written "so broadly" that they "effectively preclude [ ] the worker from working in the same field."

Challenges to the Proposal

The proposed rule is subject to a 60-day public comment period before the FTC is permitted to publish a final rule that would become effective 180 days later. The position taken by the FTC is part of the ongoing fight over the enforceability of non-compete clauses, which already faces legal challenges, with the U.S. Chamber of Commerce calling the NPRM "blatantly unlawful" and that it "is confident that this unlawful action will not stand." Given the challenges this rule will face, if it is ultimately deemed enforceable, it could be years in the making until that happens.

What Should PA Employers Do?

The proposed FTC rules may leave Pennsylvania employers not knowing what to do.

At this point — there is nothing to do. For now, Pennsylvania courts may enforce non-compete agreements that are (i) incidental to an employment relationship between the parties; (ii) supported by valuable consideration; (ii) reasonably necessary to protect the employer's legitimate business interests; and (iii) reasonably limited in time, duration and geographic territory.

Non-compete agreements have notoriously been used to protect the intellectual property of a business, including trade secrets, confidential and proprietary information. We can help avoid disputes by strategizing steps to address these intellectual property protection issues. Restricting employee access to information and trade secrets on a need-to-know basis and updating confidentiality and non-disclosure agreements are two such examples.

If you are an employer who is concerned about the enforceability of your existing non-compete agreement and whether its enforceability would remain if the FTC's proposed rule passes, please contact Beth Slagle at bas@muslaw.com or 412.456.2890, any member of our Employment Group, or any other Meyer, Unkovic & Scott attorney with whom you have worked.