

## FTC Takes on Employer Non-Compete Clauses

### In brief

Over the past week, the Federal Trade Commission ("FTC") took a major step to expand competition policy deeper into labor markets.

On July 9, 2021, President Biden signed an [Executive Order on antitrust and competition policy](#) that identified non-compete clauses as an area for greater scrutiny.<sup>i</sup> The Executive Order invited the FTC to use its "statutory rulemaking authority under the Federal Trade Commission Act to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."<sup>ii</sup> This week, the FTC significantly advanced the Executive Order's directive:

- On January 5, 2023, the FTC voted 3-1 to propose a new rule that would significantly restrict the use of non-compete clauses between employers and employees.<sup>iii</sup> The FTC's proposed rule represents the FTC's first foray into Section 5 competition rulemaking under Chair Lina Khan.
- The proposed rule follows a set of enforcement actions taken by the FTC against non-compete covenants in certain employer contracts. On January 4, 2023, just one day prior to announcing the proposed rule, the FTC voted 3-1 to issue proposed orders against two affiliated security guard companies (Prudential Security, Inc. and Prudential Command Inc.) and their owners and two glass-container companies (O-I Glass, Inc. and Ardagh Group S.A.).<sup>iv</sup> The FTC alleged that these companies

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<sup>i</sup> Executive Office of the President, Executive Order on Promoting Competition in the American Economy (July 9, 2021), <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/>.

<sup>ii</sup> *Id.*

<sup>iii</sup> Press Release, Fed. Trade Comm'n, FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition (Jan. 5, 2023), <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition>. Chair Lina M. Khan, Commissioner Rebecca K. Slaughter, and Commissioner Alvaro M. Bedoya issued a majority statement on the proposed rule. Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya, Regarding the Notice of Proposed Rulemaking to Restrict Employers' Use of Noncompete Clauses, Comm'n File No. P201200 (Jan. 5, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/statement-of-chair-lina-m-khan-joined-by-commrs-slaughter-and-bedoya-on-noncompete-nprm.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/statement-of-chair-lina-m-khan-joined-by-commrs-slaughter-and-bedoya-on-noncompete-nprm.pdf). Commissioners Slaughter and Bedoya filed a separate concurring statement. Statement of Commissioner Slaughter Joined by Commissioner Alvaro M. Bedoya, On the Notice of Proposed Rulemaking on Non-Compete Clauses, Comm'n File No. P201200 (Jan. 5, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/statement-of-commissioners-slaughter-and-bedoya-on-proposed-rulemaking-noncompete.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/statement-of-commissioners-slaughter-and-bedoya-on-proposed-rulemaking-noncompete.pdf). Commissioner Wilson filed a dissenting statement. Dissenting Statement of Commissioner Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule, Comm'n File No. P201200-1 (Jan. 5, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/p201000noncompetewilsondissent.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf).

<sup>iv</sup> Chair Lina M. Khan, Commissioner Rebecca K. Slaughter, and Commissioner Alvaro M. Bedoya issued a majority statement on these matters. Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya In the Matters of Prudential Security, O-I Glass Inc., and Ardagh Group S.A. Commission File No. 2210026 & 2110182 (Jan. 4, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/21100262110182prudentialardaghkhanslaughterbedoyastatements.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/21100262110182prudentialardaghkhanslaughterbedoyastatements.pdf); Commissioner Christine S. Wilson filed dissenting statements relating to both sets of proposed orders. Dissenting Statement of Commissioner Christine S. Wilson, In the Matter of Prudential Security, File No. 211-0026 (Jan. 4, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/wilson\\_dissenting\\_statement\\_-\\_prudential\\_security\\_-\\_final\\_-\\_1-3-23.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/wilson_dissenting_statement_-_prudential_security_-_final_-_1-3-23.pdf); Dissenting Statement of Commissioner Christine S. Wilson, In the Matter of O-I Glass, Inc. and In the Matter of Ardagh Group S.A., File No. 211-0182 (Jan. 4, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/wilson-dissenting-statement-glass-container-cases.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/wilson-dissenting-statement-glass-container-cases.pdf).

employed non-compete clauses that restrict workers' freedom to accept employment with a competing business, form a competing business, or compete with that employer in any other way.<sup>v</sup>

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## FTC's Proposed Non-Compete Rule<sup>vi</sup>

The FTC voted to propose a rule under its Section 5 competition authority that would declare employer/employee non-compete clauses an "unfair method of competition." The proposed rule states that employers cannot:

- 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.<sup>vii</sup>

The proposed rule targets both formal non-compete clauses and de facto non-compete clauses that have "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," such as certain broad non-disclosure agreements imposed on workers that have the effect of precluding employment opportunities in the same field.<sup>viii</sup>

The rule broadly defines "worker" to include a "natural person who works, whether paid or unpaid, for an employer"—including "employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer."<sup>ix</sup>

If the rule is finalized, employers with existing non-compete clauses in their contracts would be required to rescind those provisions within 180 days after the finalization and must notify the affected employees that the non-compete clause is no longer in effect.<sup>x</sup>

**Franchisee Exemption.** With respect to franchising, franchisees are expressly excluded from the definition of a worker, but any person who works for a franchisee or franchisor may be covered.<sup>xi</sup> The proposed rule also states that non-compete clauses between franchisors and franchisees would remain subject to federal antitrust law and other applicable law.

**Sale-of-Business Exemption.** The proposed rule exempts non-compete clauses for a person who sells a business entity or operating assets or is disposing of a business entity or operating assets, but the exemption would only apply to a "substantial owner" or partner in the sold business entity.<sup>xii</sup> The FTC's proposed rule defines substantial owner as an owner, member, or partner who holds at least 25 percent ownership interest in the business entity. The sale-of-business exception under the FTC's proposed rule is even more stringent than the sale-of-business exception as applied by states, such as California, which have a strong public policy against non-competition agreements.

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<sup>v</sup> Compl., *In re Prudential Security, Inc.*, Dkt. No. C-XXXX at ¶ 1 (F.T.C. 2022); accord Compl., *In re O-I Glass, Inc.*, Dkt. No. C- at ¶ 1 (F.T.C. 2022); Compl., *In re Ardagh Group S.A.*, Dkt. No. C- at ¶ 1 (F.T.C. 2022).

<sup>vi</sup> The FTC's proposed rule does not explicitly address whether employee and customer non-solicitation covenants will fall under the definition of a "non-compete clause." Depending on the employee's position and the industry, arguably, such provisions could qualify as a *de facto* non-compete clause under the FTC's proposed rule. Further, given the broad drafting of the FTC's proposed rule, it would likely prohibit "forfeiture for competition" arrangements which limit the penalty imposed on the employee to the forfeiture of certain entitlements under a compensation arrangement such as invested equity awards.

<sup>vii</sup> Notice of Proposed Rulemaking, Non-Compete Clause Rule, 17 C.F.R. Part 910.2(a) at 215 (Jan. 5, 2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/p201000noncompetenprm.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf).

<sup>viii</sup> *Id.* at Part 910.1(b)(2).

<sup>ix</sup> *Id.* at Part 910.1(f).

<sup>x</sup> *Id.* at Part 910.2(b)(1)-(2).

<sup>xi</sup> *Id.*

<sup>xii</sup> *Id.* at Part 910.3.

**State Law Pre-emption.** The FTC's proposed rule also would pre-empt state laws that provide contrary or inconsistent interpretations of non-compete clauses.<sup>xiii</sup> As of today, only a handful of states, such as California, North Dakota, and Oklahoma, have a general ban on non-competition agreements (subject to certain limited exceptions). But in the past several years, a number of states have passed laws prohibiting non-competition agreements with low income workers and/or imposed additional restrictions and requirements for valid non-competition restrictions.

**Opportunity to Provide Public Comment.** The proposed rule will be available for public comment for 60 days after it is published in the Federal Register, and interested parties may file a comment online or by paper by following the instructions provided in the notice of proposed rulemaking.

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## FTC's Non-Compete Enforcement Actions

This significant federal policy shift in the treatment of non-compete clauses comes on the heels of noteworthy enforcement actions involving non-compete clauses. In particular, the FTC announced enforcement actions affecting two industries: (1) security guard contracts; and (2) workers for certain glass container manufacturers.

**Non-Compete Clauses Affecting Security Guard Contracts.** The FTC alleged that Prudential Security and Prudential Command Inc. (collectively "Prudential"), and their sole owners Greg Wier and Matthew Keywell, employed post-employment covenants not to compete that violated Section 5 of the FTC Act, 15 U.S.C. § 45. The FTC alleged that these agreements "tend to be coercive and exploitative" and "reduc[e] job mobility, limit[] competition for employee services, and thus depriv[e] employees of higher wages and more favorable working conditions."<sup>xiv</sup>

According to the FTC's complaint, before August 2022, Prudential hired security guards as employees and offered security guard services in multiple states. The FTC alleged that Prudential required all security guard employees to sign non-compete agreements as a condition of employment that prohibited them from accepting employment within one hundred miles of the employee's primary jobsite and included a liquidated damages clause requiring employees to pay if they violated the non-compete covenant.<sup>xv</sup>

The FTC's complaint alleges that Prudential and its owners enforced the non-compete clauses in a number of ways.<sup>xvi</sup> As a result of Prudential's non-competes and its subsequent enforcement of the covenant, the FTC purported that security guards, faced with unequal bargaining power, were forced to accept onerous contract terms and were hindered from seeking other employment with higher wages or better working conditions.<sup>xvii</sup> Finally, the FTC noted that any benefits from the non-competes could have been achieved through a non-disclosure agreement.<sup>xviii</sup>

**Non-Compete Agreements Involving Glass Container Companies.** The FTC alleged that I-O Glass and Ardagh Group S.A. (collectively "Ardagh") required employees across a variety of positions to accept non-compete clauses in their contracts.<sup>xix</sup> The I-O Glass non-compete agreements, according to the FTC's complaint, often prohibited employees from directly or indirectly being employed by any business that sells products or services that were similar to I-O Glass's products without I-O Glass's prior written consent.<sup>xx</sup> The FTC's complaint alleged that Ardagh's agreement required that employees not directly or indirectly provide or

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<sup>xiii</sup> *Id.* at Part 910.4.

<sup>xiv</sup> Compl., *In re Prudential Security, Inc.* at 2.

<sup>xv</sup> *Id.* at 11-13.

<sup>xvi</sup> *Id.* at 18-22.

<sup>xvii</sup> *Id.* at 23-25.

<sup>xviii</sup> *Id.* at 25.

<sup>xix</sup> Compl., *In re O-I Glass, Inc.*, Dkt. No. C- at ¶ 7 (F.T.C. 2022); Compl., *In re Ardagh Group S.A.*, Dkt. No. C- at ¶ 9 (F.T.C. 2022).

<sup>xx</sup> Compl., *In re O-I Glass, Inc.*, at 7.

perform services for any business located in the United States, Canada, or Mexico that are similar to the services that they provided for Ardagh.<sup>xxi</sup>

In its complaints against the companies, the FTC alleged that the non-competes impeded entry and expansion by competitors, reduced employee mobility, resulted in lower wages, salaries, and reduced benefits, caused less favorable working conditions, and generally imposed personal hardship on employees.<sup>xxii</sup> The FTC also observed that the benefits of the non-compete covenants could be accomplished through a non-disclosure agreement.<sup>xxiii</sup>

**Remedies.** The FTC's proposed remedies in both sets of actions prohibited the companies (and where applicable, the individuals) from enforcing, threatening to enforce, or imposing non-compete covenants against any relevant employees in the future. The orders also prevented the companies from telling other companies that former employees were subject to non-compete covenants. They further required the companies to void the existing non-competes without imposing any penalty on affected employees and to provide copies of the FTC's proposed order to current and former employees and current and former directors, officers, and employees. Finally, the FTC's proposed orders required the companies to provide notice to any new employees that they may seek employment with another company, open their own business, or compete in any other way with the companies following their employment.

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## Key Takeaways

- The FTC's activities this week signal a considerable effort to prioritize non-compete covenants as an area for increased enforcement.
- If the FTC's proposed rule were to be finalized in its current form, a vast majority of non-compete clauses would be prohibited under Section 5 of the FTC Act.
- In the meantime, the FTC undoubtedly will continue to heavily scrutinize labor non-compete clauses through investigations and enforcement actions. With that in mind, it is important to consider the following risk factors:
  - Companies that have a pattern of aggressively enforcing non-compete clauses against employees may be at a higher risk for FTC scrutiny.
  - Companies that include large penalty clauses for violating non-compete clauses may invite scrutiny.
  - Companies that employ non-compete clauses that are overly broad in geographic scope or in the scope of employment may face enhanced scrutiny.
  - Non-compete clauses that affect a large number of employees-particularly in highly concentrated industries-may raise concerns with enforcers.
  - The FTC likely will weigh whether or not the employees were able to bargain away or at least narrow the scope of the non-compete in employment negotiations. Thus, "take it or leave it" clauses in standard forms may face greater scrutiny than highly negotiated clauses.
  - Employer/employee non-disclosure agreements that are overly broad and that have the effect of precluding future employment in an entire field may face scrutiny.
  - While non-competes between franchisors and franchisees in franchise agreements are excluded from the prohibitions under the proposed rule, the noncompetition agreements between franchisors or franchisees and their respective workers would still be covered. As a result, the proposed rule would impose significant limits on a franchisor's ability to

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<sup>xxi</sup> Compl., *In re Ardagh Group S.A.*, at 9.

<sup>xxii</sup> Compl., *In re O-I Glass, Inc.*, at 8; Compl., *In re Ardagh Group S.A.*, at 10.

<sup>xxiii</sup> Compl., *In re O-I Glass, Inc.*, at 9; Compl., *In re Ardagh Group S.A.*, at 11.

control the dissemination of proprietary information through non-compete covenants with its franchisees, managers, and employees.

Regardless of whether (or when) the proposed rule takes effect, the FTC's recent activity signals that non-compete clauses may bring greater risks than ever before. Now is the time for companies to take stock of the extent and the scope of any existing non-compete clauses to assess whether efforts can be taken to minimize risk.

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