



PILLAR LEGAL

FTC Proposes Ban on Non-Competes

U.S. TECH LAW UPDATE¹

February 28, 2023

By: Alexandra Ashbrook

On January 5, 2023, the Federal Trade Commission (“FTC”) released a Notice of Proposed Rulemaking to prohibit employers from using contractual terms with workers that prevent such workers from seeking or accepting employment from another employer or operating a business after the end of the worker’s employment with the employer (the “Proposed Rule”).² Commonly referred to as non-compete clauses or “non-competes,” these terms permit employers to sue a former worker for breach of contract if the worker begins employment at a another employer or starts a business—usually in competition with the employer—within certain geographic areas and for certain periods of time. The Proposed Rule will affect most of the U.S., including California as discussed below, where non-competes are already unenforceable but are permitted in the context of selling a business. As shown in the state survey at the end of this U.S. Tech Law Update, the vast majority of states currently permit the use of non-competes.

The Proposed Rule highlights how non-competes are “increasingly considered anticompetitive restraints of trade scrutinized under federal and state antitrust laws” by U.S. government agencies.³ Anticompetitive restraints on trade are restricted by Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices in or affecting commerce.⁴ The FTC claims that since non-competes constitute an unfair method of competition, they violate Section 5 of the FTC Act.⁵ The agency further asserts that because Section 6(g) of the FTC Act allows the FTC to make “rules and regulations for the purpose of carrying out the provisions of” the FTC Act, the FTC is empowered to create and enforce the Proposed Rule.

The FTC’s work on the Proposed Rule represents “a culmination of several years of activity by the [FTC] related to non-compete clauses and their effects on competition” which began in the mid-2010s.⁶ In 2018 and 2019, the FTC held hearings related to non-competes and invited public comment on these types of clauses.⁷ In the Proposed Rule, the FTC states that

¹ This U.S. Tech Law Update is provided by Pillar Legal, P.C. (the “Firm”) as a service to clients and other readers. The information contained in this publication should not be construed as legal advice, and use of this memorandum does not create an attorney - client relationship between the reader and the Firm. In addition, the information has not been updated since the date first set forth above and may be required to be updated or customized for particular facts and circumstances. This U.S. Tech Law Update may be considered “Attorney Advertising” under applicable law. Questions regarding the matters discussed in this publication may be directed to the Firm at the following contact details: +1-925-930-3932 (San Francisco Bay Area office), +86-21-5876-0206 (Shanghai office), email: info@pillarlegalpc.com. Firm website: www.pillarlegalpc.com. © 2023 Pillar Legal, P.C.

² [Non-Compete Clause Rule](#), FEDERAL TRADE COMMISSION, 16 CFR Part 910 (proposed Jan. 5, 2023).

³ See Proposed Rule.

⁴ See [The Antitrust Laws](#), FEDERAL TRADE COMMISSION (accessed Feb. 7, 2023).

⁵ [Federal Trade Commission Act §5](#).

⁶ Proposed Rule at 61.

⁷ [Hearings on Competition and Consumer Protection in the 21st Century](#), FEDERAL TRADE COMMISSION (accessed Feb. 7, 2023).



evidence continued to mount regarding the anticompetitive effects of non-compete clauses, which increased the agency’s focus on the issue.⁸

The Proposed Rule comes a year and a half after President Biden’s 2021 executive order encouraging the FTC to ban or limit non-compete agreements.⁹ President Biden also addressed non-competes in his State of the Union Address on February 7, 2023, stating that the U.S. government is “beginning to restore the dignity of work” by “banning [non-compete] agreements so companies have to compete for workers and pay them what they’re worth.”¹⁰

The executive branch is not alone in its battle against non-competes—the legislative branch is also currently targeting these clauses. On February 1, 2023, U.S. Senator Chris Murphy (D-Conn.) and U.S. Senator Todd Young (R-Ind.) reintroduced the Workforce Mobility Act, which would limit the use of non-competes.¹¹ This bill was also introduced by a bipartisan group of lawmakers in the U.S. House of Representatives. Senators Murphy and Young claim that non-competes are “terrible for workers,” “a major drag on economic growth,” and “stifle wage growth, career advancement, innovation, business creation, and human freedom” and that the bill aims to remove barriers created by non-competes and increase opportunities for workers.¹²

Conversely, business advocacy groups condemn the Proposed Rule. The United States Chamber of Commerce, the largest lobbying group in the U.S., which represents millions of U.S. businesses, released a statement asserting that the Proposed Rule is “blatantly unlawful” and that “Congress never delegated the FTC anything close to the authority it would need” to ban non-competes.¹³ The organization’s executive vice president vowed to lobby Congress to limit some of the FTC’s regulatory activities through the appropriations process and sue to block the Proposed Rule.¹⁴ However, with two branches of the U.S. federal government making efforts to restrict non-competes, it is unclear how successful these groups will be in attempts to preserve the clauses.

1. The FTC Argues Non-Competes Hurt America’s Workers and Economy

In a study conducted by the Economic Policy Institute in 2019, nearly 50% of respondent companies indicated that at least some of their employees were required to enter into a non-compete agreement, and nearly one-third indicated that all of their employees were required to enter into a non-compete agreement.¹⁵ The same study noted that non-competes are even common in workplaces with low pay—nearly 40% of U.S. workplaces with an average hourly wage level of less than \$13.00 per hour require some or all employees to enter into non-compete agreements.¹⁶ The same is true for workplaces that only require workers to have some high

⁸ Proposed Rule at 62.

⁹ [Exec. Order No. 14036](#), 86 CFR 132 (Jul. 9, 2021).

¹⁰ [Full Text of President Biden’s State of the Union Address](#), THE WALL STREET JOURNAL (Feb. 7, 2023).

¹¹ Clifford Atlas, Erik Winton, and Justin Theriault, [Bipartisan Bill to Ban Most Non-Compete Agreements Reintroduced in U.S. Senate](#), NATIONAL LAW REVIEW (Feb. 3, 2023).

¹² Press Release, [Murphy, Young Reintroduce Bill to Protect American Workers, Limit Non-Compete Agreements](#) (Feb. 1, 2023).

¹³ [The FTC’s Noncompete Rulemaking is Blatantly Unlawful](#), U.S. CHAMBER OF COMMERCE (Jan. 5, 2023).

¹⁴ Chelsey Cox, [U.S. Chamber of Commerce threatens to sue the FTC over proposed ban on noncompete clauses](#), CNBC (Jan. 12, 2023).

¹⁵ Alexander J.S. Colvin and Heidi Shierholz, [Non-Compete Agreements](#), ECONOMIC POLICY INSTITUTE (Dec. 10, 2019).

¹⁶ *Id.*



school education as a hiring prerequisite, with 32% of such workplaces requiring non-competes for some or all employees.¹⁷ Non-competes are used by approximately 70% of companies in business services and wholesale trade, but even sectors such as transportation, education and health services, and leisure and hospitality utilize these agreements.¹⁸

Some employers argue that non-competes have important social and economic benefits. For example, non-competes are used to protect trade secrets, increase employer incentive to provide costly training to new employees, and reduce turnover.¹⁹ However, in the Proposed Rule, the FTC claims that companies can rely on other protections, such as non-disclosure agreements and federal and state trade secret laws to protect trade secrets and other valuable investments, and that these tools are significantly less harmful to workers and the U.S. economy.

In addition, the FTC asserts that non-competes have a disproportionately negative impact on U.S. workers, exploit workers, and hinder economic liberty. Studies show that where non-competes are enforced, these agreements reduce worker bargaining power and wages and sometimes cause workers to leave their occupational fields entirely.²⁰ States that restrict non-compete clauses see wage increases for workers between 2-4%.²¹ The FTC cites studies estimating that a nationwide ban on non-competes would increase worker wages nationally almost 4%.²²

Furthermore, the FTC argues that non-competes adversely affect the country’s economy in many ways, such as by stifling innovation, foreclosing competitors’ ability to access worker talent, decreasing new business formation, and precluding the development of new industrial clusters such as California’s Silicon Valley (non-competes have been unenforceable in California since 1872).²³ Economists have found that high-tech firms tend to cluster due to several factors including “information spillovers across workers and firms” due to the movement of workers between firms within an industry.²⁴ These “spillovers” positively affect the larger economy by creating attractive destinations for firms and talent, giving rise productive and innovative industrial clusters that are advantageous to the larger economy.²⁵ However, non-competes prevent this information spillover by restricting worker movement.

2. The Proposed Rule

The Proposed Rule designates non-compete clauses as an unfair method of competition in violation of the FTC Act. It defines a “non-compete” as any contractual term between an

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Office of Economic Policy, [Non-compete Contracts: Economic Effects and Policy Implications](#), U.S. DEPARTMENT OF THE TREASURY (Mar. 2016).

²⁰ *Id.*

²¹ Proposed Rule at 19-21.

²² *Id.* at 20.

²³ *Id.* at 18-48. Under California common law, a contract not to engage in a particular business within the state was in restraint of trade and void (*More v. Bonnet* (Cal. 1870), 40 Cal. 251). The California legislature codified its ban on such restraints in 1872 with former Cal. Civ. Code § 1673. § 1673 was repealed by Stats. 1941, ch. 526 § 2, p. 1847, an enacted as Bus. & Prof. Code § 16600 in 1941.

²⁴ Office of Economic Policy, *supra* note 15; *see also* Cal. Bus. & Prof. Code § 16600.

²⁵ *Id.*



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.²⁶ However, the FTC notes that this definition does not cover non-disclosure agreements or non-solicitation agreements.²⁷ In addition, the Proposed Rule would restrict employers from imposing non-competes on any type of worker, paid or unpaid.²⁸ This includes employees, independent contractors, externs, interns, volunteers, apprentices, or sole proprietors.

Under the Proposed Rule, employers would be obligated to rescind existing non-compete clauses with workers, and inform such workers that the clauses are no longer in effect.²⁹ The final rule will include model language that will satisfy this requirement.³⁰ Moreover, the final rule will include a safe harbor provision whereby an employer will satisfy the requirement to rescind existing non-compete clauses where it provides the relevant workers with a notice that complies with the notice requirement.³¹

In addition, the Proposed Rule would prohibit an employer from attempting to enter into a non-compete clause with a worker, and from representing to a worker that the worker is covered by a non-compete clause where the employer has no good faith basis to believe the worker is subject to an enforceable non-compete clause.³² Neither of these prohibitions would apply retroactively.³³

Notably, the Proposed Rule provides a limited exception under which non-competes may be permitted between the seller and buyer of a business. Where a party restricted by the non-compete clauses is an owner, member, or partner of a business holding at least a 25% ownership interest in the business entity, the buyer of such business can require the seller to enter into a reasonable non-compete agreement.³⁴ The FTC introduced this exception because non-compete clauses between the buyer and seller of a business help protect the value of the business acquired and are distinct from non-compete clauses arising solely out of an employment context.³⁵

The Proposed Rule is not yet finalized. The FTC is currently soliciting comments from the public regarding a variety of issues related to the Proposed Rule, including whether the Proposed Rule should cover franchisees, whether senior executives of a company should be exempted from the Proposed Rule, and whether low- and high-wage workers should be treated differently under the Proposed Rule.

²⁶ *Id.* at 106.

²⁷ *Id.* at 108.

²⁸ *Id.* at 115.

²⁹ *Id.* at 118.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.* at 120.

³⁴ *Id.* at 128.

³⁵ *Id.* at 129.



3. Impacts on California

The Supremacy Clause of the U.S. Constitution provides that the laws made pursuant to the Constitution “shall be the supreme Law of the Land.”³⁶ As a result, federal law preempts any conflicting state law. While this means that in some instances a federal law may fully preempt contrary state laws, the FTC has indicated that the Proposed Rule will not supersede any state statutes, regulations, orders, or interpretations that are consistent with the Proposed Rule or provide even greater protections to workers than the Proposed Rule.³⁷ As a result, state rules that allow employers to enforce non-compete agreements in circumstance that would not be permitted under the Proposed Rule will be prohibited, but state laws that provide greater protection to workers will remain in effect.

Non-compete clauses are prohibited under California’s Business and Professions Code, which reads that “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”³⁸ So how will the Proposed Rule affect California employers and workers?

Employers Will be Prohibited from Misleading Workers with Unenforceable Non-Compete Clauses

As discussed above, the Proposed Rule prohibits an employer from even attempting to enter into a non-compete clause with a worker. Although non-competes are unenforceable in California, one study found that over 45% of employers in California require some or all workers to sign non-compete clauses anyway.³⁹ The Proposed Rule would explicitly prohibit this practice. In addition, it would become illegal for an employer to represent to a worker that the worker is covered by a non-compete clause, because the employer would not have a “good faith basis” to believe the worker is subject to an enforceable non-compete clause due to their unenforceability in California altogether.

Sellers of Businesses With Less Than a 25% Ownership Interest Will Receive Protection

California law includes an exemption from its non-compete prohibition for sellers and buyers of businesses. In other words, a buyer of a business is permitted to enter into an agreement that restricts the seller from competing with the business within a specified geographic area.⁴⁰ For a non-compete to be enforceable under this exception, the parties must value or consider goodwill as a component of the sales price for the business and the transaction must clearly establish that it falls within the exception from California’s statutory prohibition on non-competes.⁴¹ In addition, the seller must sell *all* of his stock in the company and hold a substantial portion of the stock as would permit the conclusion that the company’s goodwill is

³⁶ U.S. Const. art. VI, cl. 2.

³⁷ Proposed Rule at 132.

³⁸ Cal. Bus. & Prof. Code § 16600.

³⁹ Alexander J.S. Colvin and Heidi Shierholz, [Non-Compete Agreements](#), ECONOMIC POLICY INSTITUTE (Dec. 10, 2019).

⁴⁰ Cal. Bus. & Prof. Code § 16601.

⁴¹ *Hill Med. Corp. v. Wycoff*, 86 Cal. App. 4th 895, 903 (2001); *Fillpoint, LLC v. Maas*, 208 Cal. App. 4th 1170, 1178 (2012).



also being transferred (note, however, that this can be a low percentage of outstanding stock).⁴² To be valid, the non-compete must also comply with California’s statutory and judicially-imposed limitations on such agreements regarding geographic scope, duration, and scope.⁴³

However, the Proposed Rule sets a new floor for protection that will preempt certain aspects of California’s rule. Under the Proposed Rule, buyers and sellers of businesses would only receive an exemption from the ban on non-compete agreements in the event the seller is an owner, member, or partner that owns at least a 25% ownership interest in the sold business.⁴⁴ This means that buyers in California would be prohibited from attempting to enter into non-compete agreements with sellers of a business who own less than 25% of that business. Note, in the event that a seller owns at least 25% of the sold business, California’s limitations regarding geographic scope, duration, and scope of conduct would still apply, as these limitations offer a greater level of protection than the Proposed Rule.

4. Non-Competes Across the U.S.

If enacted, the Proposed Rule will affect most states by either requiring higher levels of protection than current state law or overturning state laws that permit non-competes. Only three states generally prohibit the use of non-competes, whereas thirty-four states (including Washington, D.C.) impose limits on their use (such as for certain employees or within certain professions), and fourteen states permit them so long as they are “reasonable.” Below are several categorizations describing the permissibility of non-competes across the U.S., and descriptions of some of the types of laws applicable within the states covered under such categorization:

- Non-Competes Generally Prohibited. These states generally prohibit non-competes, with certain exceptions. For example, California exempts the sale of a business from its non-compete prohibition.
- Non-Competes Prohibited For Certain Employees. In these states, the use of non-competes is only permitted with respect to certain employees. Usually, non-competes with employees earning below a certain income threshold are unenforceable. However, some states such as Idaho only permit non-competes with “key employees” (i.e., employees who have gained a high level of inside knowledge, influence, credibility, etc. as a representative or spokesperson of the employer). In Maine, non-competes are only enforceable against workers employed at least a year (or remain employed at least six months after the non-compete is signed, whichever is longer). Note that these states may also limit non-competes in other ways as well. About 24%

⁴² *Radian Industries, inc. v. Skirvin*, Cal. App. 2nd Dist. (1973); see also *Vacco Industries, Inc. v. Van Den Berg*, 5 Cal. App 4th 34, 48 (1992). Note that in *Vacco Industries*, the court held that the defendant was a “substantial shareholder” as the ninth largest shareholder in the corporation and one of its principal officers. The defendant in that case only held 3% of the company’s outstanding shares.

⁴³ In California, the territorial scope of non-competes is generally limited to those areas in which the goodwill of a business is established (*Kaplan v. Nalpak Corp.*, Cal. App. 2nd Dist. (1958)), but is not necessarily limited to California counties or cities (*Fleming v. Ray-Suzuki, Inc.*, Cal. App. 4th Dist. (1990)). The duration of a non-compete may continue so long as the buyer of the business carries on the business in the relevant territory, but is often contractually limited to a few years (see *Martinez v. Martinez*, 41. Cal. 2nd 704 (1953)). Non-competes may not restrict an individual from practicing his profession (*Hill. Med. Corp. v. Wycoff*, Cal. App. 2nd Dist. (2001)).

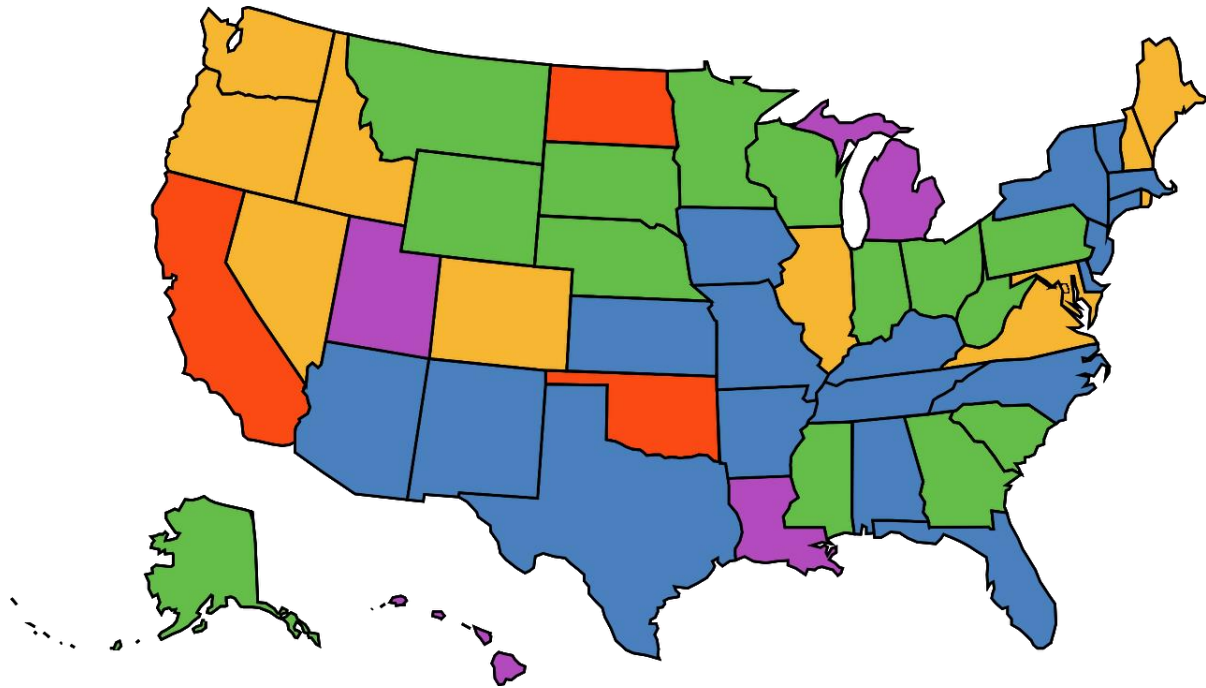
⁴⁴ Proposed Rule at 5.



of states (including Washington, D.C.) prohibit non-competes for certain types of employees.

- Non-Competes Permitted But Limited. These states permit non-competes but have limited them even further beyond the general restrictions and/or exemptions present under common law. Some states require non-competes to protect a business’ legitimate interest beyond just preventing competition, and others impose strict time, duration, and scope standards. Note that some of these states also prohibit the use of non-competes in certain professions in addition to these restrictions.
- Non-Competes Permitted Except In Certain Professions. These states generally permit non-competes except in certain professions, such as broadcasting, health care, and finance. Prohibitions on non-competes in certain industries are somewhat common in the U.S., with nearly 60% of states (including Washington, D.C.) prohibiting their use within certain professions.
- Non-Competes Generally Permitted. These states generally permit non-competes so long as they are reasonable and do not go against “public policy.”

The below graphic and table demonstrate the status of non-competes across all U.S. states as of February 2023.



■ Non-Competes Generally Prohibited	■ Non-Competes Prohibited For Certain Employees	■ Non-Competes Permitted But Limited	■ Non-Competes Permitted Except In Certain Professions	■ Non-Competes Generally Permitted
--	---	--	--	---



PILLAR LEGAL

STATE	RELEVANT LAW
Non-Competes Generally Prohibited	
California	Cal. Bus. And Prof. Code §§ 16600-16607
North Dakota	N.D. Cent. Code §9-08-06
Oklahoma	Okla Stat. tit. 15, § 217 to 219B
Non-Competes Prohibited For Certain Employees	
Colorado	Colo. Rev. Stat §8-2-113
District of Columbia	Ban on Non-Compete Agreements Amendment Act of 2020 Non-Compete Clarification Amendment Act of 2022
Idaho	Idaho Code §§44-2701 to 2704
Illinois	820 ILCS 90
Oregon	Or. Rev. Stat. §653.295
Maine	26 MRSA §599-A 26 MRSA § 599
Maryland	MD Code Ann., Lab. & Empl. §3-716
Nevada	Nev. Rev. Stat. §613.195-200 and AB 276, Section 1
New Hampshire	NH RSA 275:70 NH RSA 275:70-a NH RSA 329:31-a
Rhode Island	R.I. Gen. Laws 5-37-33 The Rhode Island Noncompetition Agreement Act § 28-59-3
Virginia	Va. Code Ann. § 40.1-27.7:8
Washington	Wash. Rev. Code §§49.52.005-900
Non-Competes Permitted But Limited	
Hawaii	Haw. Rev. Stat. §480-4
Louisiana	La. Rev. Stat. Ann. § 23-921
Michigan	Mich. Comp. Laws § 445.774a
Utah	UT Code Ann. §§ 34-51-101-301
Non-Competes Permitted Except in Certain Professions	
Alabama	Ala. Code § 8-1-190 et seq.
Arizona	Arizona Common Law
Arkansas	Ark. Code Ann. § 4-75-101
Connecticut	Conn. Gen. Stat. Ann. § 20-14p Conn. Gen. Stat. §31-50a Conn. Gen. Stat. §31-50b
Delaware	Del. Code Ann. Tit. 6, § 2707
Florida	Fla. Stat. Ann. §542.335
Iowa	Iowa Common Law
Kansas	Kansas Common Law
Kentucky	Kentucky Common Law
Massachusetts	Mass. Gen. Laws ch. 149, § 24L Mass. Gen. Laws ch. 112, § 74D Mass. Gen. Laws ch. 112, § 135C Mass. Gen. Laws ch. 149, § 186
Missouri	Mo. Stat. Ann. §431.202
New Jersey	New Jersey Common Law
New Mexico	N.M.S.A. 1978, §§24-11-1-5
New York	New York Common Law
North Carolina	N.C. Gen. Stat. § 75-1 et seq.
Tennessee	Tennessee Common Law
Texas	Tex. Bus. & Comm. Code §§15.50-.52
Vermont	26 V.S.A. § 281(c)
Non-Competes Generally Permitted	
Alaska	Alaska Common Law
Georgia	Ga. Code Ann. § 13-6-50 et seq.
Indiana	Ind. Code Ann. §25-22.5



PILLAR LEGAL

Minnesota	Minnesota Common Law
Mississippi	Mississippi Common Law
Montana	Mont. Code Ann. §§27-2-703-705
Nebraska	Nebraska Common Law
Ohio	Ohio Common Law
Pennsylvania	Pennsylvania Common Law
South Carolina	South Carolina Common Law
South Dakota	S.D. Codified Laws §53-9-8
West Virginia	W. Va. Code 47-11E-1-5
Wisconsin	Wis. Stat. Ann. §103.465
Wyoming	Wyoming Common Law