

# FTC Contemplates Banning Non-Compete Covenants in Franchise Agreements

Article By:

Michael K. Molzberger

Ann H. MacDonald

Linda M. Jackson

Kylie S. Wood

---

On January 5, 2023, the Federal Trade Commission (FTC) published a proposed rule that, with limited exceptions, would both ban post-termination non-compete covenants in employment agreements and require rescission of existing post-termination non-competes. The proposed rule expressly would not apply to franchise agreements. But the FTC's notice of proposed rulemaking seeks public comments on whether the proposed rule should be broadened to ban post-termination non-competes in franchise agreements between franchisors and franchisees.

The FTC's notice of proposed rulemaking notes that many franchise agreements contain post-termination non-compete covenants. The FTC's notice claims that those non-competes could "potentially stifle new business formation and innovation, reduce the earnings of franchisees, and have other negative effects on competitive conditions similar to non-compete clauses between employers and workers." The FTC's Franchise Rule already requires franchisors to provide a franchise disclosure document ("FDD") to potential franchisees and requires that the FDD disclose non-compete clauses. 16 CFR 436(i); 436(q).

The proposed rule can be found [here](#).

## The Proposed Rule

At this time, the proposed rule would apply broadly to any "Worker." "Worker" is defined to include employees, independent contractors, and any individual who works for an employer, whether paid or unpaid (e.g., externs, interns, volunteers, apprentices, or sole proprietors). "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."

The proposed rule applies to non-compete agreements that expressly prohibit a worker from seeking

---

or accepting certain employment after the conclusion of the worker's employment with the employer, and also applies to provisions that have the effect of a non-compete clause. The FTC lists contractual terms that could be deemed such a *de facto* non-compete provision:

- Broad Non-disclosure agreements that effectively preclude the worker from working in the same field after the conclusion of the worker's employment with the employer; and
- Contractual terms that require the worker to pay for training costs that are not reasonably related to the employer's cost to train the worker if the worker's employment terminates within a specified time period.

The FTC's proposed rule not only bans non-compete provisions moving forward, but would also require employers to rescind any existing non-competes within six months of the Rule's publication and provide notice to employees "in an individualized communication" that such restrictions are no longer in effect and may not be enforced against the worker.

## **Expansion of the Proposed Rule into the Franchise Context Could Dramatically Alter the Franchise Landscape**

The FTC issued the Notice of Proposed Rulemaking (NPRM) on a 3-1 Commission vote. Commissioner Christine Wilson, the dissenting vote, described the proposed rule as "a radical departure from hundreds of years of legal precedent." If, in fact, the proposed rule was modified to apply to the franchisor-franchisee relationship and adopted, it could dramatically change the franchise landscape by opening the door for franchisees to trade on the franchisor's brand, goodwill, practices, trade secrets, and other confidential information.

### **Next Steps**

The FTC has established a 60-day comment period for affected parties to submit public comments in response to the rule. Related to the possible expansion of the proposed rule in the franchise context, the FTC seeks comments as to:

- Whether the proposed rule should cover non-compete covenants in franchise agreements;
- If the proposed rule were to cover franchise agreements, whether non-compete covenants should be outright banned or subject to a rebuttable presumption of unlawfulness (and what the standard for rebutting the presumption should be); and
- If the proposed rule were to cover franchise agreements, whether certain categories of non-compete covenants should be exempted or subject to different standards.

The FTC's notice of proposed rulemaking expressly encourages commenters to provide data or other evidence that could assist the FTC as it considers whether the proposed rule should be expanded to apply to the franchise context.

In the event that the FTC does adopt the proposed rule, there will be significant legal challenges about whether the FTC exceeded its authority.

National Law Review, Volumess XIII, Number 7

Source URL: <https://natlawreview.com/article/ftc-contemplates-banning-non-compete-covenants-franchise-agreements>