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Insights

FTC Issues Rule Banning Non-Compete Agreements

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On April 23, 2024, the Federal Trade Commission (FTC) announced its final rule banning virtually all employee non-compete agreements nationwide in approximately 120 days. The FTC initially issued its proposed rule in January 2023. The FTC thereafter received and considered over 26,000 comments to the rule before issuing the final rule. The FTC voted 3-2 along party lines, determining that non-compete agreements are an unfair method of competition under Section 5 of the FTC Act. The effect of this final rule is significant to almost all employees and employers, as well as a wide range of other workers.

The primary takeaways of the final rule:

- All non-compete agreements for workers, even those who have existing agreements, are banned, with one exception;
- The one exception for workers is that *existing* non-competes are not banned for "*senior executive*" workers, defined as workers earning more than $151,164 and who are in a policy making position. Employers are banned, however, from entering into a new non-compete with senior executives;
- Employers must provide notice to workers bound by an existing non-compete agreement that the non-compete agreement will not be enforced against them in the future;
- Employers outside the FTC's jurisdiction under the FTC Act are not subject to the final rule, meaning certain industries are exempt. Potentially exempt employers include nonprofit organizations, banks, insurance companies, and air carriers. However, the final rule pointedly indicates that not *all* entities claiming tax-exempt status as nonprofit organizations fall outside of FTC jurisdiction; thus there will certainly be further controversy on that point.
- Those who have non-competes reached in the sale of business context are not subject to the rule.

The final rule will become effective 120 days after its publication in the Federal Register, which should occur in the short coming days. The rule, however, has received significant dissent. The rule is almost certain to receive legal challenges on multiple bases and will be litigated in the courts. Indeed, as of today there are at least two lawsuits that have already been filed seeking to enjoin and invalidate the rule. If these actions succeed, the effective date of the final rule may be delayed for months or even years. This is similar to other hotly contested topics such as the student loan forgiveness rules. Nonetheless, employers should be prepared should this final rule ever become effective, which includes understanding how it changes future and current non-compete clauses and agreements.

1. THE FINAL RULE

The looming questions that employers universally face are threefold: (1) does this apply to your workplace and employees; (2) what does it prohibit; and (3) are there any exceptions?

a. Does the final rule apply to your workplace and employees?

The short answer is likely yes. This final rule is extremely broad. The final rule begins with a definition section and broadly defines the following terms: business entity, employment, non-compete clause, officer, person, policy-making authority, policy-making position, preceding year, senior executive, total annual compensation, and worker. The definitions are important in determining whether this final rule applies to your workplace and employees. The most relevant of these terms are defined in the final rule as follows:

i. "Business entity" includes a partnership, corporation, association, limited liability company, or other legal entity, or a division or subsidiary of that entity.

ii. "Employment" is defined as "work for a person."

iii. "Person" includes "any natural person, partnership, corporation, association, or other legal entity within the [FTC's] jurisdiction, including any person acting under color or authority of State law."

iv. "Worker" is defined as "a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or the worker's status under any other State or Federal laws, including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person." Additionally, worker includes "a natural person who works for a franchisee or franchisor, but does not include a franchisee in the context of a franchisee-franchisor relationship."

Given these broad definitions, it will be extremely difficult if not impossible for employers to find a loophole in this final rule's application to its business and workers.

b. What does the final rule prohibit?

The final rule prohibits virtually all worker non-compete clauses. As it relates to workers the final rule prohibits: (1) entering into or attempting to enter into a non-compete clause; (2) enforcing or attempting to enforce a non-compete clause; or (3) representing that the worker is subject to a non-compete clause. The final rule also discusses what constitutes a "non-compete clause." A "non-compete clause" broadly includes "a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (1) seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or (2) operating a business in the United States after the conclusion of the employment that includes the term or condition." This broad definition covers what are commonly considered non-compete agreements.

As noted above, there is one exception to certain workers. With respect to "senior executive" workers, defined to include workers in policy-making decisions who made at least $151,164 in the year prior to the final rules effective date, the same prohibitions apply *except* that employers may still seek to enforce non-competes entered into *prior* to the effective date of the final rule with senior executives.

Last, the final rule requires employers to issue a notice to workers with existing non-compete clauses that such clauses will not be and cannot legally be enforced against the worker. The notice must identify the parties to the non-compete clause and be delivered to the worker by mail, email, or text. The final rule provides the following model language that employers may use for this notice:

A new rule enforced by the Federal Trade Commission makes it unlawful for us to enforce a non-compete clause. As of [DATE EMPLOYER CHOOSES BUT NO LATER THAN EFFECTIVE DATE OF THE FINAL RULE], [EMPLOYER NAME] will not enforce any non-compete clause against you. This means that as of [DATE EMPLOYER CHOOSES BUT NO LATER THAN EFFECTIVE DATE OF THE FINAL RULE]:

- You may seek or accept a job with any company or any person—even if they compete with [EMPLOYER NAME].
- You may run your own business—even if it competes with [EMPLOYER NAME].
- You may compete with [EMPLOYER NAME] following your employment with [EMPLOYER NAME].

The FTC's new rule does not affect any other terms or conditions of your employment. For more information about the rule, visit [*link to final rule landing page*]. Complete and accurate translations of the notice in certain languages other than English, including Spanish, Chinese, Arabic, Vietnamese, Tagalog, and Korean, are available at [URL on FTC's website].

c. Are there any other exceptions?

Yes, there is an exception limited to what is commonly considered a sale of business situation. The final rule provides an exception for non-compete clauses entered into by a person selling a business, otherwise disposing of the person's ownership interest in the business entity, or by a person selling all or substantially all of the business entity's operating assets. There are also exceptions for those in a franchisee – franchisor relationship, for certain nonprofit organizations, and to those entities to which the FTC traditionally does not apply.

The final rule does not prohibit employers from pursuing lawsuits against workers who violated their non-compete before the effective date of the rule.

2. CURRENT TAKEAWAYS

We expect to see many legal challenges to this final rule because it is a major shift in decades of legal development and law enforcing non-competes. It is possible that employers will never be required to abide by these prohibitions; but employers should prepare and stay abreast of the final rule's status should it ever become effective. More consideration should be given to confidentiality agreements, non-disclosure agreements, and non-solicitation agreements, and maintaining your confidential information as trade secret information. The final rule itself listed some of these actions as permissible alternatives. Our Labor and Employment team will continue to follow the final rule and any action as a result. If you need assistance revising your policies, auditing your current agreements, preparing the required notice, or have questions regarding the final rule please contact Scott S. Morrisson, Elizabeth M. Roberson, Chloe N. Craft, or another member of our Labor and Employment Practice.